S. Hrg. 99-748

TITLE XI BANKRUPTCY REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON
MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 1992

TO PRESERVE THE RIGHTS OF CERTAIN PARTIES WITH AN INTEREST IN CERTAIN VESSELS OR FISHING FACILITIES, AND FOR OTHER PURPOSES

S. 1993

TO PRESERVE THE RIGHTS OF CERTAIN PARTIES WITH AN INTEREST IN AIRCRAFTS, AIRCRAFT PARTS, OR VESSELS, AND FOR OTHER PURPOSES

MARCH 21, 1986

Printed for the use of the
Committee on Commerce, Science, and Transportation

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TITLE XI BANKRUPTCY REFORM

FRIDAY, MARCH 21, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON MERCHANT MARINE
Washington, D. C.

The subcommittee met, pursuant to notice, at 9:10 a.m., in Room SR-253, Russell Senate Office Building, Hon. Ted Stevens, [chairman of the subcommittee] presiding.

Staff members assigned to this hearing: Brad Gilman, professional staff member and John Hardy, minority staff counsel.

OPENING STATEMENT BY SENATOR STEVENS

Senator STEVENS. Good morning.

Senator Inouye has had an unfortunate situation develop in his family and will not be present today.

He understands that we are going to proceed with the hearing anyway.

I have an opening statement from him that I will insert into the record.

At the end of the last session, I introduced S. 1992 and S. 1993 on behalf of the Secretaries of Commerce and Transportation. These bills would provide discretionary authority to all secured creditors to foreclose on vessels guaranteed under title XI of the Merchant Marine Act of 1936.

The Bankruptcy Code currently imposes an automatic stay on the foreclosure of assets by creditors during the pendency of bankruptcy proceedings. Creditors still have the opportunity to petition the bankruptcy judge to lift this stay.

S. 1992 would amend Chapter 11 of the Bankruptcy Code relating to wage earners. S. 1993 would amend Chapter 11 of the code relating to corporate reorganization.

These two proposals would, in effect, exempt all secured creditors from the automatic stay of the provisions of the code.

[The statement and bills follow:]

OPENING STATEMENT BY SENATOR INOUYE

The Legislation before the subcommittee this morning gives limited discretionary authority to all creditors having a debt secured by a vessel to foreclose on that security in the event of bankruptcy. It is therefore broader than similar legislation passed by the Senate in the 97th Congress.

I would hope that the testimony the subcommittee receives this morning will help us to determine if additional measures are necessary to protect the title XI security interest of the Federal Government; and if so, how broad such a measure should be.

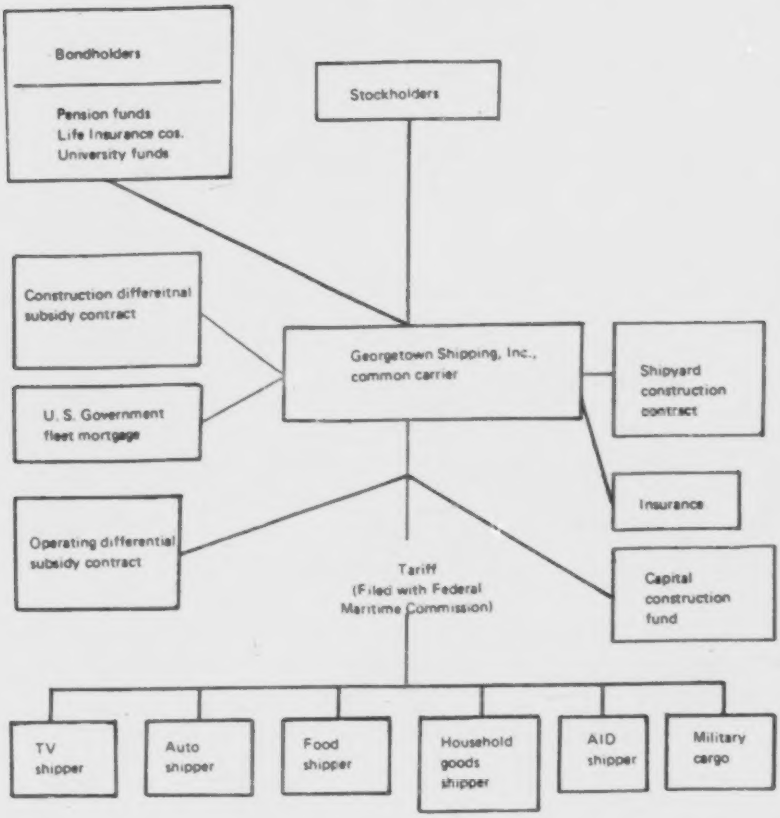
Pursuant to the guarantee program authorized by title XI of the Merchant Marine Act of 1936, the Secretary of Transportation guarantees obligations sold in the private market to finance or refinance the construction, reconstruction or reconditioning of U.S.-flag vessels in domestic shipyards. The Secretary of Commerce has similar authority under title XI with respect to fishing vessels and facilities. The usual security of the purchaser of title XI guaranteed obligations in the private market is the title XI guarantee that if the shipowner of facility owner does not pay the obligations the U.S. Government will. The security for the U.S. Government as guarantor is the vessel or facility, as the case may be (i.e., a preferred mortgage on the vessel or a realty mortgage on the fishery facility). Over the years, most U.S.-flag commercial operators have taken advantage of the title XI guarantee program. Recently, However, according to the administration, this program has been confronted by a problem. It concerns the ability of the Secretary to foreclose in a timely manner on the security for the title XI guarantee when operators of vessels or fishery facilities which participate in the title XI program default on their obligations (i.e., principal and interest payments on the bonds), and go into bankruptcy.

Prior to enactment of the Bankruptcy Reform Act of 1978, in the event of a title XI default by a shipowner in bankruptcy, the bankruptcy court did not have the statutory authority to enjoin the Secretary from foreclosing forthwith on the vessel mortgage of the debtor shipowner, if the Secretary determined that such a foreclosure was in the best interest of the Government.

The 1978 act did not continue that provision, however. As a consequence the Secretary of Transportation and the Secretary of Commerce are now effectively blocked by the automatic stay provisions of the bankruptcy code from foreclosing on the title XI security for vessels and fishery facilities. Instead they must first resort to procedures prescribed by the bankruptcy code to seek relief from the stay. According to the administration these procedures are "time-consuming and often arduous."

At this point I would like to include for the record two outlines of possible ship financing projects which illustrate the Government's title XI secured interest in each case as well as the entire spectrum of financing, construction, subsidy, and operations.

Conventional Title XI Financing [1]


Bondholders
Pension funds
Life Insurance cos.
University funds
Stockholders
Construction differeitnal subsidy contract
U. S. Government fleet mortgage
Georgetown Shipping, Inc., common carrier
Shipyard construction contract
Insurance
Operating differential subsidy contract
Tariff (Filed with Federal Maritime Commission)
Capital construction fund
TV shipper
Auto shipper
Food shipper
Household goods shipper
AID shipper
Military cargo

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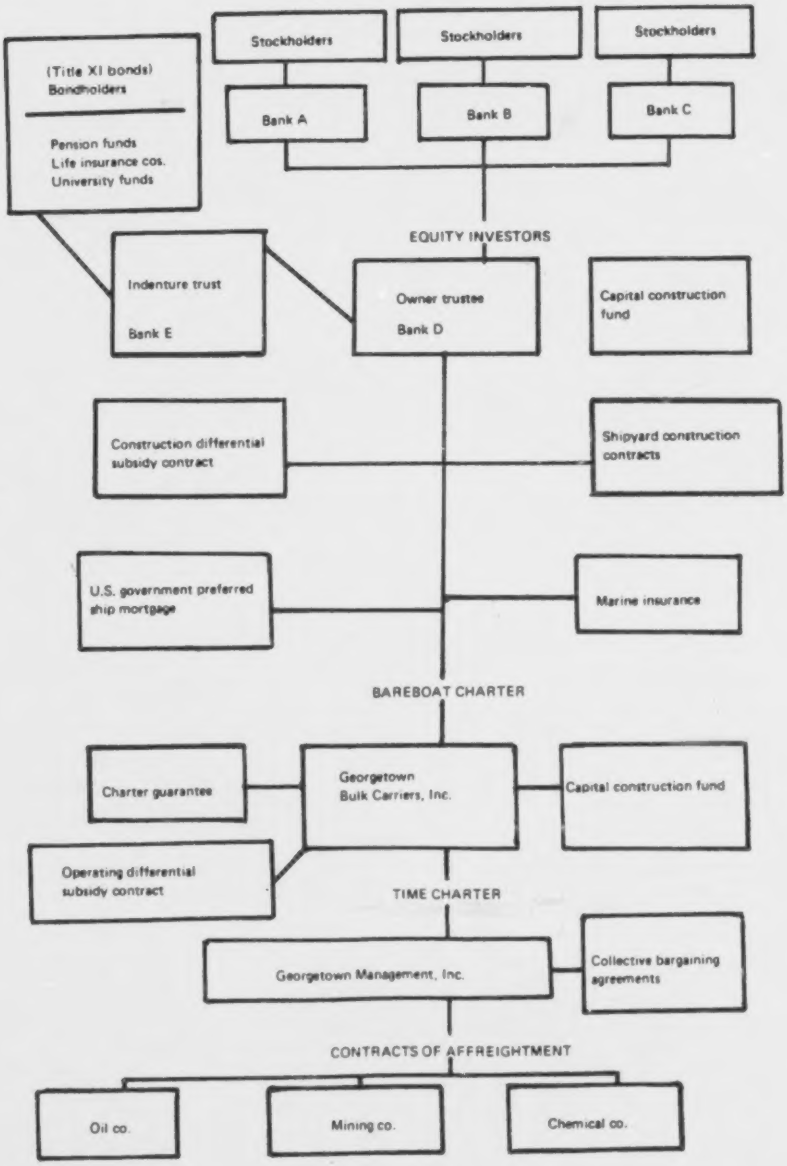
[1] Maritime Law, The Need for a Comprehensive Maritime Code, Malia, Gerald A., Associated Faculty Press, Inc. (1983), p. 118

Title XI Lease Financing [2]


Stockholders
Stockholders
Stockholders
(Title XI bonds)
Bondholders
Pension funds
Life insurance cos.
University funds
Bank A
Bank B
Bank C
EQUITY INVESTORS
Indenture trust
Bank E
Owner trustee
Bank D
Capital construction fund
Construction differential subsidy contract
Shipyard construction contracts
U.S. government preferred ship mortgage
Marine insurance
BAREBOAT CHARTER
Charter guarantee
Georgetown
Bulk Carriers, Inc.
Capital construction fund
Operating differential subsidy contract
TIME CHARTER
Georgetown Management, Inc.
Collective bargaining agreements
CONTRACTS OF AFFREIGHTMENT
Oil co.
Mining co.
Chemical co.

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[2] Maritime Law, The Need for a Comprehensive Maritime Code, Malia, Gerald A., Associated Faculty Press, Inc. (1983), p. 119

99TH CONGRESS
2D SESSION

S. 1992

To preserve the rights of certain parties with an interest in certain vessels or fishing facilities, and for other purposes.

IN THE SENATE OF THE UNITED STATES

DECEMBER 19 (legislative day, DECEMBER 16), 1985

Mr. STEVENS (by request) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

MARCH 11 (legislative day, MARCH 10), 1986

Ordered, that when reported, the bill be referred to the Committee on the Judiciary for its consideration of those provisions concerning title II of the United States Code, for a period not to exceed fourteen calendar days

---

A BILL

To preserve the rights of certain parties with an interest in certain vessels or fishing facilities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subchapter I of chapter 13 of title 11, United States Code, is amended by adding at the end thereof the following:

"§ 1308. Fishing vessels and facilities

"(a) The right of a secured party with an interest arising from a preferred ship mortgage under the Ship Mortgage

Act, 1920 in, or of a lessor or conditional vendor of, whether as trustee or otherwise, a vessel as defined by section 1101(b) of the Merchant Marine Act of 1936 (46 U.S.C. 1271(b)), or the right of a secured party with an interest arising from a mortgage on, or other security interest in, a fishery facility as defined by section 1101(k) of the Merchant Marine Act of 1936 (46 U.S.C. 1271(k)), to take possession of and foreclose on such equipment or facility in compliance with the provisions of the preferred ship mortgage, such other mortgage, security agreement, lease, or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession or disposition, unless—

"(1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such preferred ship mortgage, mortgage, security agreement, lease, or conditional sale contract, as the case may be; and

"(2) any default, other than a default of a kind specified in section 365(b)(2) of this title under such preferred ship mortgage, mortgage, security agreement, lease, or conditional sale contract, as the case may be—

"(A) that occurred before such date is cured before the expiration of such 60-day period; and

"(B) that occurs after such date is cured before the later of—

"(i) 30 days after the date of such default; and

"(ii) the expiration of such 60-day period.

"(b) Any cure under subsection (a)(2) may only be established by payment to the secured party, lessor, or conditional vendor in full in cash of an amount equal to all sums owed, plus payments of all applicable interest.

"(c) The trustee and the secured party, lessor, or conditional vendor, as the case may be, whose right to take possession is protected under subsection (a) of this section may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1) of this section.".

(b) The chapter analysis of chapter 13 of title 11, United States Code, is amended by adding at the end of subchapter I the following:

"1308. Fishing vessels and facilities.".

○

II

99th CONGRESS
2d Session

S. 1993

To preserve the rights of certain parties with an interest in aircrafts, aircraft parts, or vessels, and for other purposes.

IN THE SENATE OF THE UNITED STATES

December 19 (legislative day, December 16), 1985

Mr. Stevens (by request) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

March 11 (legislative day, March 10), 1986

Ordered, that when reported, the bill be referred to the Committee on the Judiciary for consideration of those provisions concerning title XI, United States Code, for a period not to exceed fourteen calendar days

---

A BILL

To preserve the rights of certain parties with an interest in aircrafts, aircraft parts, or vessels, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1110(a) of title 11, United States Code, is amended to read as follows:

"(a) The right of a secured party with a purchase-money equipment security interest in, or of a lessor or conditional vendor of, whether as trustee or otherwise, aircraft, aircraft engines, propellers, appliances, or spare parts as defined in section 101 of the Federal Aviation Act of 1958 (49 U.S.C. 1301) that are subject to a purchase-money equipment security interest granted by, leased to, or conditionally sold to, a debtor that is an air carrier operating under a certificate of convenience and necessity issued by the Department of Transportation under section 401 of the Federal Aviation Act of 1958 (49 U.S.C. 1371), to take possession of and foreclose on such equipment in compliance with the provisions of a purchase-money equipment security agreement, lease, or conditional sale contract, as the case may be, or the right of a secured party with an interest arising from a preferred ship mortgage as defined under the Ship Mortgage Act, 1920, in, or of a lessor or conditional vendor of, whether as trustee or otherwise, a vessel as defined by section 1101(b) of the Merchant Marine Act of 1936 (46 App. U.S.C. 1271(b)), or the right of a secured party with an interest arising from a mortgage on, or other security interest in, a fishery facility as defined in section 1101(k) of the Merchant Marine Act of 1936 (46 App. U.S.C. 1271(k)), or of a party with a security interest under any State law applicable to such vessel or facility while under construction, including, but not limited to equipment and appurtenances relating thereto, to take possession of and foreclose on such vessel or facility, or vessel or facility under construction, in compliance with the provisions of the preferred ship mortgage, such other mortgage, other security interest, lease or conditional sale contract, as the case may be, is not affected by section 362 or 363 of this title or by any power of the court to enjoin such taking of possession or disposition, unless—

"(1) before 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after such date under such preferred ship mortgage, mortgage, security agreement, lease, or conditional sale contract, as the case may be; and

"(2) any default, other than a default of a kind specified in section 365(b)(2) of this title, under such preferred ship mortgage, mortgage, security agreement, lease, or conditional sale contract, as the case may be—

"(A) that occurred before such date is cured before the expiration of such 60-day period; and

"(B) that occurs after such date is cured before the later of—

"(i) 30 days after the date of such default; and

"(ii) the expiration of such 60-day period.

"Any cure under subsection (a)(2) may only be established by payment to the secured party, lessor, or conditional vendor in full in cash of an amount equal to all sums owed, plus payment of all applicable interest.".

○

Senator STEVENS. Do we have two panels at one time, or one panel?

[Pause]

Senator STEVENS. Mr. Gaughan, you are representing the Maritime Administration, and Mr. Douglas is representing NOAA, is that right?

STATEMENTS OF JOHN A. GAUGHAN, ADMINISTRATOR, MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY RICHARD E. BOWMAN, ASSOCIATE ADMINISTRATOR FOR MARITIME AIDS; ROBERT J. PATTON, ACTING CHIEF COUNSEL; AND JAMES E. DOUGLAS, JR., ACTING DEPUTY ASSISTANT ADMINISTRATOR FOR FISHERIES, NATIONAL MARINE FISHERIES SERVICE, NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION, DEPARTMENT OF COMMERCE; ACCOMPANIED BY MICHAEL L. GRABLE, CHIEF OF FINANCIAL SERVICES DIVISION; AND JOHN PEDRICK, COUNSEL

Mr. GAUGHAN. That's correct, Mr. Chairman.

Senator STEVENS. Fine.

We are pleased to have your testimony.

Mr. Gaughan.

Mr. GAUGHAN. Mr. Chairman, first of all, I want to thank you and the committee for taking time to hold this hearing.

I am John Gaughan, the Maritime Administrator. I am accompanied by Mr. Dick Bowman and Mr. Bob Patton of my staff.

You will have to excuse me, Mr. Chairman, but I just raced in from getting off an airplane.

My testimony this morning, sir, will be limited to S. 1993, which would amend Chapter 11 of the Bankruptcy Code to provide a partial immunity from the automatic stay to creditors with preferred ship mortgages. The witness from the Department of Commerce will address problems that are encountered under the title XI Fisheries Guarantee Program managed by that Department.

Pursuant to the Guarantee Program authorized by title XI of the Merchant Marine Act of 1936, the Secretary of Transportation has been authorized to guarantee obligations sold in the private market to finance or refinance the construction, reconstruction or reconditioning of U.S.-flag vessels in domestic shipyards.

All guarantee fees and receipts under the title XI program are deposited into a Federal Ship Financing Fund, which was intended to sustain the title XI program. In the event of a shipowner default on payment of title XI debt, the Government must honor its guarantee and pay the bondholders or noteholders in full.

If the fund is exhausted, the Secretary is authorized to borrow money directly from the U.S. Treasury to pay off on defaults.

Prior to fiscal year 1983, the title XI program experienced only occasional defaults despite the cyclical nature of the shipping industry. It now seems clear, however, Mr. Chairman, that we are not in the middle of a normal cyclical shipping downturn, but rather one of the longest sustained maritime recessions in 50 years.

The economic recession in the inland, offshore supply and drilling industries is expected to continue as long as world crude oil prices are depressed.

The consequence of this abnormal cycle has been aggregate title XI defaults in fiscal year 1983 of $91 million, in fiscal year 1984 of $101 million, in fiscal year 1985 of $320 million. To date, in fiscal year 1986, title XI defaults have aggregated $659 million.

The reserves in the Federal Ship Financing Fund were exhausted in fiscal year 1985, and we have since borrowed $795 million from the U.S. Treasury to cover those losses We expect that aggregate borrowings from the Treasury could rise to $1 billion or more in the next several months.

The present outstanding portfolio of title XI is approximately $6 billion.

While any projection of "recovery" from this current, unprecedented cycle is extremely hazardous, we do expect that by the beginning of next year, the portfolio should be more manageable without the kind of ongoing large defaults presently being experienced.

However, the continuing decline in oil prices, already a major cause for the current sustained downward cycle, could extend this projection further into the future.

Mr. Chairman, the current situation is very serious, and one of our major problems in managing the problem is the bankruptcy law. It prohibits us from foreclosing on the vessel used as security for the title XI debt. This would appear to result from a misunderstanding when the Bankruptcy Act was revised in 1978.

Prior to the 1978 revision, in the event of a title XI default by a shipowner, the Bankruptcy Court did not have the statutory authority to stay the Secretary from foreclosing on the vessel mortgage of the debtor shipowner if the Secretary determined that such a foreclosure was in the best interest of the Government.

The revised Bankruptcy Code did not continue the Secretary's absolute immunity from the bankruptcy stay provisions. Instead, the Secretary, as well as other secured creditors with interests in various types of transportation equipment were intended to have a qualified immunity from the stay provisions under section 1110.

Apparently inadvertently, the class of vessels to which qualified immunity from the stay provisions applied was limited to certain domestic/inland vessels regulated by the ICC.

Unfortunately, the bulk of the vessels presently covered by title XI guarantees are not ICC-regulated. As a result, the Secretary of Transportation is effectively blocked by the automatic stay provisions of the code from foreclosing on the title XI security and must resort to the costly, time-consuming, and arduous procedure required to seek relief from the bankruptcy stay.

Since the enactment of the 1978 Bankruptcy Code revision, the Department has experienced considerable frustration in realizing on its collateral for the title XI debt because of the automatic stay provision. The Department is currently precluded by the stay of various Bankruptcy Courts from foreclosing on assets that secure over $400 million in defaulted title XI obligations, an amount which is rising weekly.

Experience indicates probably 2 years on the average for contested cases at best before the Department obtains relief from the stay order or an agreeable plan of reorganization.

Experience also suggests that because of the Government's inability to foreclose promptly, the Bankruptcy Courts will be filled in large part by ship owners whose principal motivation is to keep their tax credits from unwinding.

The delays in foreclosing on collateral vessels also exacerbate an already depressed market, in many cases allowing vessels to further depress the markets by operating without any capital costs. The delay in foreclosing moreover lengthens the time for repayment to the Federal Treasury.

Finally, the delay adversely affects the financial viability of nondefaulting operators. The companies in bankruptcy, operating without servicing any capital debt, are in a position to cut rates to the detriment of their competitors. This, in turn, adds to the threat to the continued viability of the nondefaulting title XI companies.

In my opinion, the current financial crisis in many sectors of the maritime industry is, in part, a result of this unequal competition between companies in Chapter 11 bankruptcy and other operators in the industry.

To overcome these problems, the administration has proposed legislation that you introduced as S. 1993. The bill would amend section 1110 of the Bankruptcy Code to provide a partial immunity from the automatic stay to creditors with preferred ship mortgages.

The amendment to section 1110 would broaden the class of vessels included within the exemption to all vessels potentially covered by title XI guarantees and would establish parity with the Government's and private lenders' present rights with regard to loans to aviation and rail industries who have the same exemption.

The shipowner in Chapter 11 bankruptcy who has defaulted on his title XI obligations would be entitled to continue to use the vessel or vessels for 60 days after the order from relief under the Bankruptcy Code has been entered. Thereafter, such continued use would be permitted only if the debtor cures his outstanding debts.

The amendment would extend these rights to both private and Governmental lenders, continuing the present philosophy of the Code of treating Government and private creditors alike.

Mr. Chairman, section 1110, as amended by S. 1993, would not conflict with the Secretary's obligation to the bondholders or noteholders under the title XI Guarantee Program. It would, however, correct an unintended partial omission of portions of the maritime industry from qualified relief from the automatic stay provision and would end a situation that is aggravating the current recession in the industry. It would also end a situation that as presently constituted is unfair to the Government and the American taxpayer.

Those who honor their title XI obligations have to compete with those who do not. The former cannot long survive under that competition. The Government's present recourse is to pay off in full on its obligation and pursue years of litigation.

In the meantime, the Federal deficit continues to grow so that all taxpayers ultimately finance the present scheme.

Mr. Chairman, that concludes my prepared statement, but I would like to touch on one fundamental question, and that is why maritime interests should be treated differently from other interests in terms of the Bankruptcy Code.

The answer is that maritime interests are unique.

Vessels move from point to point, and certainly for the larger vessels they move overseas. That poses special problems. Also, the vessels obviously are in a marine environment, which accelerates deterioration of the equipment faster than for land-based equipment.

In recognition of the uniqueness of the sea, maritime law, since the founding of our Nation, has been special, with its own precedents and procedures. In financing, the uniqueness is reflected in a statutory ship mortgage for secured creditors in recognition of the special risks involved and the problems of attracting capital.

Investing in shipping is not a financial bonanza, and the unprecedented recession and problems with bankruptcies are not helping any future financing of shipping.

Finally, the maritime industry is distinct in this regard. The enabling legislation also laid out a very important promotional responsibility. For example, vessels are also unique because of our defense reliance on them when we need them the most, because of their contribution to balance of payments, and because of their assurance of the flow of U.S. water-borne commerce competitively and to all ports in the world.

There are, therefore, sound reasons for the treatment that would be accorded maritime secured interests in S. 1992 and S. 1993, if they are enacted.

Thank you very much, Mr. Chairman.

I would be prepared, with my staff, to answer any questions that the committee might have.

Senator STEVENS. I am interested in your statement, which states that the Secretary of Transportation is effectively blocked by the automatic stay provisions of the Bankruptcy Code from foreclosing on the title XI security and must resort to the costly, time-consuming, and arduous procedure required to seek relief from the bankruptcy stay.

Tell me about that.

How long is it?

Mr. GAUGHAN. Mr. Chairman, I am going to ask Mr. Patton to give you some of the specifics. But I know in my own experience of one case that has certainly been underway for more than 2 years while that company continued to operate.

Senator STEVENS. Mr. Patton, how many such cases have you pending right now?

Mr. PATTON. We have approximately, in bankruptcy alone, a dozen and a half to two dozen cases.

Senator STEVENS. And how many have you sought relief for from the court?

Mr. PATTON. I don't recall the exact numbers. At least a dozen, I believe.

We can provide exactly which cases and which relief.

[The following information was subsequently received for the record:]

Technically, there are 48 cases pending in which title XI debtor has petitioned a bankruptcy court for protection under Chapter 11 of the 1978 Bankrupty Code. Several of these cases are consolidated or treated as consolidated, such as the Marsea Companies, which involves 16 cases. Of the 48 cases, the Government has filed motions for relief from the automatic stay provision of the Bankruptcy Code in 32 cases.

Senator STEVENS. Have they obtained any relief yet from the court?

Mr. PATTON. In the contested cases, we have obtained relief, in terms of recent cases, in one case only to date.

Senator STEVENS. How about in noncontested cases?

Mr. PATTON. In noncontested cases, we have either reached an agreement—in those cases that have been filed a year or more, we have reached agreement; in other cases, the foreclosure process is continuing.

Senator STEVENS. How many title XI loans are outstanding at this time?

Mr. BOWMAN. Mr. Chairman, the outstanding loans at this point make a portfolio of approximately $6 billion.

Senator STEVENS. How many—in number, how many?

Mr. BOWMAN. We will have to provide the exact number.

Senator STEVENS. Well, I want to see what the relationship is. Do you have 12 cases in court, Mr. Patton?

Mr. PATTON. Approximately two dozen cases. Eighteen to 24 is my recollection.

Senator STEVENS. I would like to have that for the record, and how many loans are outstanding. I think it would be important for us to establish how large a group is going to be affected by this legislation, if it passes.

Mr. PATTON. Mr. Chairman, I might note that in fiscal year 1986 alone, there have been 32 defaults, nine of which, I believe, have been into bankruptcy, not counting previous defaults in other years and anticipated defaults yet to come.

Mr. BOWMAN. Mr. Chairman, I might add to that. As I indicated, there is a $6 billion portfolio. We are anticipating a billion dollars of that will have defaulted before mid-summer, in terms of the dollar amounts. We wiil provide you the specific number of companies.

[The following information was subsequently received for the record:]

As of September 30, 1985, there were 569 contracts in force.

Question. Please furnish the following information to the committee: (1) the number of contested bankruptcy cases; (2) the average length of time between the motion to lift the stay and the final lifting of the stay, and the ranqe of that time; (3) the number of cases for which a motion to remove the stay has been filed; and (4) the number of times the Maritime Administration was requested to participate in a Reorganization Plan?

Answer. (1) The Maritime Administration is currently involved in 48 contested bankruptcy cases. (2) The average length of time between the motion to lift the stay and relief from the stay is 18.6 months. The greatest length of time was 27 months; the shortest was 2 months. (3) A motion to remove the stay was filed in 32 bankruptcy cases. (4) The Maritime Administration was requested to participate in a reorganization plan in 7 cases.

Senator STEVENS. Mr. Hardy, Senator Inouye's assistant, has given me a list of the current title XI Guarantee Program bankruptcies. This would indicate a series of bankruptcies and also indicates that one has a pending acceptable plan; another a relief from stay is granted; another with adequate protection payments made; another one, adequate protection made; there are four on that page with adequate protection made.

Those are the cases filed before 1986. In 1986, three were filed in March of this year and are are pending and await a hearing. Three more are pending from the last part of 1985; and 32 defaults are noted in 1986. Only nine of the defaults are listed on this.

I am interestsed in finding out the reasons for delay in granting relief and the impact of the Secretary's application on the Bankruptcy Court.

I will put this in the record, Mr. Hardy.

Mr. Hardy has also informed me of a question and answer sheet prepared by MarAd which describes the steps involved in the foreclosure process for a defaulted mortgage payment, Government acquisition of assets, and distribution of assets in typical bankruptcy cases.

We will put both of those in the record so that we will have some background.

[The following information was subsequently received for the record:]

CURRENT TITLE XI GUARANTEE PROGRAM BANKRUPTCIES

[Dollar amounts in millions]

Company	Vessels	Payoff date	Date of relief or disposition of asset	Present exposure (Mar. 18, 1986)
Waterman Steamship Corp.	2 lash/351 lighters	January 1984	Pending acceptable plan (some debt remains in place).	$20.5
Tractug Associates	6 tugs	November 1983	Relief from stay granted Dec. 85; pending admiralty proceedings.	26.3
Marsea Marine Co's	16 tug/supply	July 1983–February 1984.	Adequate protection payments made; voluntary return of vessels commenced; on appeal by Marsea.	52.3
Bruce Boats	13 crewboats	June 1984	Adequate protection payments received; pending acceptable plan.	3.7
Levy-Melon	6 tug/supply	February 1985	Adequate protection payments received; still pending.	18.8
L&L Marine	3 tugs/8 barges	August 1984–January 1985.	Adequate protection payments made, partial relief granted; otherwise, pending.	12.5
Marine Logistics	9 tugs/14 barges	Mar. 7, 1986	Pending 1st hearing	68.6
Global	3 drill rigs	Mar. 7, 1986	Pending 1st hearing (more defaults expected).	97.0
National Fleet/National Boat.	8 tug/supply vessels	Oct. 24, 1985	Pending hearing which was continued by Court to Mar. 25, 1986 (some debt remains in place).	19.4
Wisconsin Barge	240 barges/9 towboats	January 1986–February 1986.	Pending 1st hearing	30.2
Sea level	2 tug/supply	July 17, 1985	Received adequate protection payments; otherwise, continuing.	6.1
Seatrain	2 VLCC tankers	Oct. 16, 1985–Dec. 6, 1985.	Pending 1st hearing; 1st plan was rejected.	58.6
Tacoma (At-Sea)	2 incinerator vessels under construction.	Nov. 19, 1985	Pending 1st hearing	63.8
Gulf Pacific	4 tug/supply	June 27, 1985	Received some negotiated payments—continuing.	10.1

Note.—In fiscal year 1986 there were 32 defaults totaling $659.6 million. Only nine of those defaults are listed above. Because of that experience and the expectancy of further defaults, there is a strong likelihood of a substantial number of new bankruptcies.

RECENT PAST TITLE XI GUARANTEE PROGRAM BANKRUPTCIES

[Dollar amounts in millions]

Company	Vessels	Payoff date	Date of relief or disposition of assets	Present exposure
Nolty J. Theriot, Inc	11 tugs	July–August 1983	February 1984	$11.8
American Atlantic Shipping, Inc.	3 breakbulks	March 1983	February 1984	14.9
Briley Co's	3 tug/supply	July 1983	March–April 1984	4.0
Robin Towing Corporation	10 tugs/2 crewboats	August 1983	June 1984	5.0
LeBeouf Bros	4 river tugs	July 1983	May 1985	2.5

TITLE XI DEFAULTS SINCE 1955

[Dollar amounts in millions]

Company	Vessels	Amount
Fiscal year 1958: TMT Trailer Ferry	1 trailer ferry	$4.1
Fiscal year 1959: Textron, Inc	1 passenger ship	2.5
Fiscal year 1961: Coastwise Lines	1 cargo ship	.5
Fiscal year 1961: Containerships, Inc	1 containership	3.3

TITLE XI DEFAULTS SINCE 1955—Continued

[Dollar amounts in millions]

Company	Vessels	Amount
Red Hills Corp	1 tanker	3.7
Fiscal year 1966: Tankers & Tramps	1 tanker	8.3
Fiscal year 1969: Northwest Hydrofoil	1 hydrofoil passenger	.9
Fiscal year 1973: Prudential Lines	1 cargo/passenger	2.8
Fiscal year 1978:		
National Transport	1 tanker	1.8
Pacific Far East Line	3 containerships	31.5
Pacific Far East Line	806 lash barges	34.1
Pacific Far East Line	1 Ro/Ro	42.0
Fiscal year 1979: States Steamship	3 cargo ships	18.7
Fiscal year 1981: Manhattan Barge	1 ocean tug, 2 ocean barges	16.2
Fiscal year 1983:		
American Atlantic	3 breakbulks	13.0
Merit Drilling	1 posted drilling barge	6.9
Nolty Theriot	9 ocean tugs	10.3
Marsea 2, 3, 5, 6, 8, 11, 12, 14, 17	9 tug/supply vessels	28.7
LeBeouf Bros	4 river towboats	2.3
Mardrill	4 drilling/workover barges	12.0
Briley	3 tug/supply vessels	6.3
Robin Towing	4 ocean tugs	5.0
Nolty Theriot	9 ocean tugs	1.5
Grasso Barge	6 river barges	5.2
Total		91.2
Fiscal year 1984:		
Waterman Steamship	325 lighters	20.5
Marsea 1, 4, 7, 9, 10, 15, 16	7 tug/supply vessels	23.6
Tractug Associates	8 tractor tugs	26.3
Garber Bros	3 tug/supply vessels	5.9
Mu-Petco	5 ocean barges	12.8
General Marine	1 ocean tug	4.5
	1 ocean barge	
Luke	1 river barge	.7
Bruce Boat	6 crewboats	3.7
	7 crew supply vessels	
L&L Marine		3.3
Total		101.3

DEFAULTS IN FISCAL YEAR 1986

[Dollar amounts in millions]

Company	No.	Type of vessel	Amount of default	Date of default
Dotco One, Inc	1	Ocean tug	$4.7	Oct. 1, 1985.
	1	Ocean barge		
Allied Barge, Inc	3	Ocean barges	8.3	Oct. 11, 1985.
				Nov. 5, 1985.
Boston VLCC Tankers VI	1	Tanker	29.5	Oct. 16, 1985.
National Fleet Corporation	2	Tug/supply vessels	19.5	Oct. 23, 1985.
	6	Supply vessels		
Petromar Offshore, Ltd	3	Tug/supply vessels	11.1	Oct. 30, 1985.
1973 Barge Leasing	10	Dry cargo river barges	2.1	Nov. 6, 1985.
Goldrus Marine Drilling Co	2	Posted drilling vessels	16.1	Nov. 12, 1985.
At-Sea Incineration Inc	2	Incinerator vessels	63.9	Nov. 19, 1985.
G&A Limited I	1	Jack-up drilling rig	28.1	Nov. 21, 1985.
Columbia Tanker Co	1	LNG	65.4	Nov. 25, 1985.

DEFAULTS IN FISCAL YEAR 1986—Continued

[Dollar amounts in millions]

Company	No.	Type of vessel	Amount of default	Date of default
Wisconsin Barge Line, Inc	68	River barges	22.8	Dec. 5, 1985.
	1	River towboat		
Boston VLCC Tankers II	1	Tanker	27.7	Dec. 6, 1985.
ML Barge Pool Partners	50	River hopper barges	8.8	Dec. 9, 1985.
Gulfdrill Limited 1	1	Jack-up drill rig	14.5	Dec. 20, 1985.
Offshore Southern Ships	1	Tug/supply vessel	2.1	Dec. 23, 1985.
Ocean Marine Services Part 1	4	Tug/supply vessels	7.8	Feb. 6, 1986.
Wisconsin Barge Line, Inc	147	River barges	15.4	Feb. 12, 1986.
	3	River switchboats		
	3	River towboats		
SCMO Barge Lines, Inc	90	River hopper barges	14.6	Feb. 13, 1986.
PAWG Marine, Inc	2	River tug boats	.6	Feb. 19, 1986.
Pelham Marine, Inc	7	Tug/supply vessels	16.3	Do.
SCF Barge Lines, Inc	7	River barges	1.4	Do.
SCF Towboat Partners II	1	River towboat	3.9	Do.
Offshore Logistics, Inc	8	Supply vessels	24.9	Do.
	4	Towing supply vessels		Do.
Linden, Inc	5	Tug/supply vessels	13.5	Do.
Shearson River III, IV, V and VII	60	River hopper barges	15.8	Feb. 27, 1986.
Trico Limited III	4	Tug/supply vessels	9.2	Mar. 4, 1986.
Global Marine Deepwater	3	Jack-up drilling rigs	97.1	Mar. 7, 1986.
Marine Logistics Corporation	7	Ocean tugs	73.4	Do.
Offshore Logistics, Inc	4	Tug/supply vessel	18.6	Mar. 12, 1986.
	7	Towing supply vessels		
	1	Crew utility boat		
Boston VLCC Tankers, Inc. II	1	Tanker	.8	Do.
Boston VLCC Tankers, Inc. VI	1	Tanker	.6	Do.
Hutbrance Drilling Co	1	Jack-up drilling rig	21.1	Do.
Total	536		659.6	

DEFAULTS IN FISCAL YEAR 1985

[Dollar amounts in millions]

Company	No.	Type of vessel	Amount of default	Date of default
Universal Salvage Co	1	River salvage barge	$0.7	Oct. 5, 1984.
AquaMarine Associates	4	Tug/supply vessels	6.7	Nov. 14, 1984.
				Jan. 11, 1985.
				Mar. 14, 1985.
				June 26, 1985.
L&L Marine Services, Inc	6	Ocean barges	4.3	Jan. 17, 1935.
Levy-Mallon Marine	6	Tub/supply vessels	18.8	Feb. 25, 1985.
Phoenix Bulkships I and II	2	LGNs	135.6	May 24, 1985.
Allied Towing	1	Tanker	13.8	May 15, 1985.
Riverway Co	50	River hopper barges	10.8	May 1985.
Gulf-Pacific Partnership	4	Tug/supply vessels	10.1	June 26, 1985.
Blocker Marine Ltd. I	2	Posted drilling barges	14.6	July 1985.
Rio Marine, Inc	7	River barges	8.1	Do.
I.S. Joseph Barge Co	25	River barges	6.0	August 1985.
G&A Limited II	1	Jack-up drilling rig	29.1	Do.
Sea Level International, Inc	2	Towing supply vessels	6.1	Aug. 2, 1985.
Glendel Limited I and II	2	Drilling barges	12.2	Aug. 29, 1985.
Petromar Marine, Inc	6	Tug/supply vessels	22.2	September 1985.

DEFAULTS IN FISCAL YEAR 1985—Continued

[Dollar amounts in millions]

Company	No.	Type of vessel	Amount of default	Date of default
Goldrus Marine Drilling	2	Posted drilling vessels	15.3	Sept. 12, 1985.
Barge Operating Co	15	River hopper barges	2.6	Do.
Dotco One, Inc	1	Ocean tug	3.8	Sept. 25, 1985.
	1	Ocean barge		
Totals	138		320.8	

Question. Please describe the steps involved in the process of default, foreclosure, mortgage payment, government acquisition of assets, and disposition of assets in a typical bankruptcy case. Which steps would S. 1993 affect?

MAJOR POINTS

Answer.

A. *Default*

(1) The shipowner, unable to make the required payments of principal and interest due on a Title XI guaranteed vessel loan, defaults on the debt obligation.

(2) The financial institution acting as the indenture trustee responsible for managing matters associated with the guaranteed debt obligation has 60 days in which to notify the Secretary of Transportation (Secretary) by letter that a payment default has continued for a minimum of 30 days and demands payment of the outstanding principal and interest.

(3) The Secretary is required to pay off the outstanding principal and interest amount within 30 days of notification of demand for payment. The Secretary uses funds from the Federal Ship Financing Fund, if possible, or borrows from the U.S. Treasury for the purpose of making prompt payments. The security of the Government for issuing a Title XI guarantee usually is a preferred mortgage on the vessel.

(4) The Secretary refers the case to the Department Of Justice (DOJ) to institute foreclosure proceedings in Admiralty Court against the collateral vessel and defaulting shipowner.

(5) The DOJ attempts to have the vessel arrested and attempts to commence foreclosure proceedings.

B. *Bankruptcy*

(1) If the shipowner files for reorganization in bankruptcy under Chapter 11 of the Bankruptcy Code, stay provisions automatically prohibit any creditors from taking action against the operator or the vessel until the bankruptcy court affirmatively lifts the stay. There are two grounds for an order to obtain relief from the automatic stay: (a) cause, including lack of adequate protection or (b) the debtor has no equity in vessels and the vessels are not necessary to an effective reorganization. (The debtor has an exclusive right to file a reorganization plan for at least 120 days.) While under the protection of the bankruptcy court, the shipowner may continue to operate the Title XI vessel.

(2) The DOJ enters an appearance in the Bankruptcy Court on behalf of the Secretary.

(3) The DOJ may petition the court for adequate protection payments on the vessel. If it can be shown that a creditor's interest in a vessel is not being adequately protected, the court may among other remedies require the operator to make payments to the Secretary on a regular basis. What constitutes adequate protection is largely a matter of discretion with the court. Payments can be based on an appraised value of the collateral, which is often a value lower than the outstanding debt. Failure by the shipowner to make these payments is a basis for lifting the automatic stay.

(4) The DOJ moves the court for relief from the stay.

(5) Lengthy discovery may occur prior to a hearing concerning relief from the stay. Continuations frequently occur, and delays arise over possible reorganization plans.

(a) In theory bankruptcy law provides that once a motion for relief from stay is filed, a creditor should obtain a judicial adjudication within ninety days. The code specifically provides that thirty days after a request for relief is filed, unless the court, after notice and a hearing (a preliminary hearing), orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination, such stay is terminated.

(b) The reality of practice is far from the theory. When preliminary hearings are held they may not be held within thirty days of filing. At such hearings it is rare that any evidence is taken and it is highly unlikely that a judge will not continue a matter to final hearing.

(6) Congested judicial calendars make it difficult in certain courts to obtain a final hearing within thirty days of the preliminary hearing. In one instance the court selected a final hearing three months after the preliminary hearing and the preliminary hearing was not held for two months after the initial filing date.

(7) Once a final hearing has been held a judicial decision is not likely to be obtained within thirty days.

(8) Assuming a favorable bankruptcy court decision, that decision may be appealed to the district court and the bankruptcy court may stay its relief order.

(9) A favorable district court decision may be appealed to a circuit court and the original relief order stayed. Alternatively, an unfavorable district court decision to the shipowner may be remanded with delays and possible appeal arising from the remand order.

C. *Foreclosure*

(1) Once the automatic stay is lifted, the vessel may be arrested pursuant to admiralty foreclosure proceedings. The United States must commence an action *in rem* to sell the vessel in the U.S. District Court. Sales of vessels rarely occur in bankruptcy without the consent of the debtor.

(2) Upon the determination by the U.S. District Court judge that the United States is entitled to have a sale, an Admiralty foreclosure sale is scheduled.

(3) Bids on the ship may be placed by the Secretary as well as any other interested bidders. However, the Secretary credit bids are usually the highest and often the only bids at the foreclosure sales.

(4) Disposition of the vessel then becomes the responsibility of the Secretary, as shipowner. Vessels normally are offered for sale, but could be chartered or simply retained under government ownership.

D. *Administration's Bill*

S. 1993 would give the Secretary partial immunity from the stay provisions of the Bankruptcy Code and enable her to recover, in part, some of the losses in a bankruptcy situation within a relatively short period of time. A shipowner defaulting on a Title XI loan would be allowed 60 days after filing for relief under bankruptcy to cure all outstanding defaults. If the shipowner fails to cure all defaults, the stay would be lifted and an Admiralty foreclosure sale could be ordered.

Background

Prior to enactment of the Bankruptcy Reform Act of 1978, the Secretary had the right to foreclose on the vessel mortgage of a debtor shipowner who filed for bankruptcy whenever it was determined that such foreclosure was in the best interest of the Government.

The Secretary's authority to foreclose on a mortgage in a timely manner while the vessel owner is in bankruptcy court (as is currently permitted certain creditors of aircraft, rolling stock, and vessels operated by water carriers certificated by the ICC) was inadvertently omitted from the Bankruptcy Reform Act of 1978.

The inability of the Secretary to rely on its collateral has been one factor which has resulted in the current insolvency of the Title XI program.

Senator STEVENS. I would like you to develop the statistics in this area, if you would.

Mr. GAUGHAN. I most certainly will, Mr. Chairman.

Senator STEVENS. I am constrained to say that it is no surprise to me that this is a strange period that we are going through, from 1983 to now. We have not been able to get any cooperation at all to prevent the downturn in the maritime situation.

We had a hearing on that yesterday, Mr. Gaughan, and there is no use going back over the situation and beating a dead horse. But I just do not understand why, if we recognize the problem, that a program cannot be devised to try to stem the tide of these losses, rather than just protect the Government at the time the losses occur.

Mr. Gaughan, there is no market for drill rigs. And I gather there is no market for vessels.

Giving the United States priority, in effect, to move ahead of other creditors at this time, what is this going to do? You are going to recover only a small fraction of the original investment, whether vessels or drilling rigs. In particular, in the tanker area and the drilling rig area, what good is it going to do you to get a hold of these assets?

Mr. GAUGHAN. Mr. Chairman, first of all, having paid off, if we are able to get control of the equipment, we can, first of all, insure that the equipment is maintained if we put it in a lay-up status, if there do appear to be markets that develop, say overseas, out of the Gulf and so forth. Most importantly, it does remove that equipment from the marketplace so that in those situations where operators are operating under the protection of bankruptcy and not paying their capital costs, they are not further skewing the market and depressing the market.

Senator STEVENS. Do you have any statistics about the number of times that MarAd has been requested to participate in a consolidation of creditors under Chapter 11 and what actions MarAd has taken?

I am led to believe that one of the reasons this bill may be necessary is that MarAd has been unwilling to enter into agreements when all other creditors are willing to do so. This bill would permit MarAd to move ahead alone and not force the Government to be part of the composition of creditors in a bankruptcy case.

Is that correct?

Mr. BOWMAN. That is not correct, Mr. Chairman.

With regard to title XI, we have made it clear that when there is a difficulty and a company starts to show with their financial reports that there is a difficulty, we start meeting, in some cases, a year or more in advance of when a final default is paid off. We have expressed right on up through the time of a default the willingness to work together.

But, therein lies the uniqueness of the bankruptcy situation. The Maritime Administration, with regard to the vessels we finance, are first preferred mortgages. When you get together, the threat of bankruptcy by the title holders is laid in front of us, in the sense of "here is our proposed workout," if you will, Mr. Chairman, and here is what we want you, the Maritime Administration, with a first secured mortgage, here the position we want you to take, and if you don't take it, we'll file under Chapter 11, you'll pay off, and we'll continue to operate.

So, it is not an even bargaining set of circumstances that we are under.

Therein lies the leverage that is carried by the ship owner and the threat of bankruptcy.

We have not been unreasonable. We have tried to work together, and there are a few cases where that has happened. But, for the most part, that is not a position where we have much bargaining power.

In addition, Mr. Chairman, there are a number of cases where a company wants to continue just in order to have its tax advantages vest. They are not particularly interested or able, given the downturn particularly in the oil industry. They have bled all their resources out. They have used all their corporate money, if you will, or the money of the partners, and they are down to the tax advantages that they want to vest.

In many cases they say to us here is what we want you to do: we want you to leave the equipment with us, we want you to pay it off and at the end of the vesting time, we'll give it back to you.

We say that that is unacceptable, that that does not provide us an adequate use agreement, and what they say is okay, we'll file, and at the end of the filing and at the end of the time the tax advantages vest, they turn the equipment over. In many cases, in some of the cases that we have had, that is precisely what happens.

Mr. GAUGHAN. Mr. Chairman, if I might just add a point, I have had presented to me proposals that would have MarAd, in essence, potentially be the operator with the equipment continuing with a particular company. As the promotional agency in markets where there are other operators that are in some cases non-title XI financed or mixed-title XI, I do not want to see my agency become an operator and a competitor.

Another situation is——

Senator STEVENS. But won't you be that if you have a situation where you control the assets and there is no market for them?

Where is the market, Mr. Gaughan? The only market I know for the assets you are seeking to acquire priority on are in foreign markets.

My understanding, particularly for the drill rigs, is the administration has refused to approve sale of drilling rigs abroad; but if this foreclosure goes through, the only market that is available is abroad .

Mr. GAUGHAN. Mr. Chairman, one of the things that we are exploring is mechanisms or ways of literally stacking rigs so that we can reduce the daily cost of maintenance to have those rigs off the market, but preserved, if you will, so that if and when the market turns up, that equipment is available for resale or whatever.

Senator STEVENS. Are you saying that the Government does not intend to seek foreign markets for the vessels and the rigs?

Mr. GAUGHAN. No, sir. I did not mean to limit it to stacking, Mr. Chairman.

We certainly look at whatever opportunities might be available to provide a recovery to the investment that has been paid off—foreign market or whatever. Yes, sir.

[The following information was subsequently received for the record:]

Question. What is the Maritime Administration's policy on foreign sales of defaulted title XI equipment?

Answer. MarAd has actively explored possible foreign sales of defaulted equipment. In most of these instances, the sales price would probably have been unacceptably low: foreign purchasers apparently are not willing to offer prices superior to domestic purchasers in most cases. However, MarAd has no policy objection to the foreign cash sale of most defaulted vessel types that have previously been offered for a domestic sale and were not built with construction-differential subsidy (CDS). Vessels built with CDS may not be sold foreign without a specific Congressional waiver.

Senator STEVENS. Very well.

Senator Gorton, do you have any questions.

Senator GORTON. No, no questions. Thank you.

Senator STEVENS. Very well.

We appreciate your testimony.

We will be happy to have you remain or depart, as you see fit.

Mr. Gaughan, Mr. Bowman, Mr. Patton, thank you for your help.

Mr. Douglas.

Mr. DOUGLAS. Thank you very much, Mr. Chairman.

I would like to introduce to you Mr. Mike Grable, on my left, and on my far left, Mr. John Pedrick. Mr. Pedrick is our attorney who deals with bankruptcies and Mr. Grable is our Program Chief who operates financial programs.

You have my statement and I would like to request that it be submitted for the record.

Senator STEVENS. Yes, sir. It will be.

Mr. DOUGLAS. If the Chairman would agree, I think we can probably capsulize the Department of Commerce's position because MarAd's testimony has amply, I think, characterized the title XI obligation guarantee program.

The National Marine Fisheries Service administers that portion of the title XI program which guarantees the financing of fishing vessels and shoreside fish processing facilities.

The fishing industry has suffered severe economic problems in the last 5 years, as the Chairman is well aware. Consequently, defaulted financings and the title XI program's contingent liability have matured at a rate unparalleled in the program's history.

After the program's capitalization was exhausted in 1982, the funds to meet its matured liability had to be borrowed from the Treasury at historically high interest rates.

There is a crucial need to promptly liquidate the program's receivables in order to repay any Treasury debt, and that has proven to be impossible to meet for a variety of reasons. On the average, it has taken more than one and a half years from the time the program first initiates mortgage foreclosure to realize any foreclosure proceeds. One case actually has required over 4 years.

The Chairman asked several statistics of the MarAd administration, and I can add here for your information that our data shows that 403 days on the average is attributable to automatic stays under bankruptcy proceedings.

Senator STEVENS. How many have you sought? Do you know, Mr. Douglas?

Mr. DOUGLAS. Excuse me, sir?

Senator STEVENS. How many times have you sought the relief of the court, the same kind of relief this bill would grant you automatically?

Mr. DOUGLAS. We have had 10 bankruptcy proceedings under Chapter 11, where we have opposed the court's reorganizational plan, and it involved a stay under that court.

For your information, Mr. Chairman, that is where we get the 403 day average. That goes from a high of 984 days to a low of 120 days. That is just for the stay provision.

You would have to tack on to that the added time it takes the U.S. Attorney's Ofice and the marshalls to go through the actual liquidation process.

Senator STEVENS. You don't have quite the same problem in terms of loss of jurisdiction that MarAd has, do you? Most of yours are shoreside facilities and coast-wise vessels, aren't they?

Mr. DOUGLAS. There are very few shoreside facilities. There are more vessels. And we would have the same problem of that vessel being mobile and able to get outside of the reach of our jurisdiction into Latin America, South America, and those places.

Certainly you can hide a fishing vessel maybe even more easily than a large transport vessel, Mr. Chairman.

If I might continue, sir, bankruptcy proceedings have been a major impediment. None of the 10 vessel owner reorganizations that involved automatic stays under Chapter 11 and opposed by the program have really resulted in any successful reorganization. They have merely postponed the inevitable and served to increase the program's losses.

In our experience, bankruptcy courts do not critically review debtor reorganization plans where fishing is concerned. They are not experts in the fishing business, nor do we expect them to be. The creditors are at a disadvantage in resisting any imposition of unrealistic plans.

Vessel collateral deteriorates very rapidly if it is not maintained, and under those 403 days average, that collateral is deteriorating all the time.

Prior to the 1978 Bankruptcy Code, the bankruptcy courts could not enjoin the foreclosure of a preferred ship mortgage held by a Federal agency if that foreclosure would be in the best interest of the United States.

As you have heard, both of these bills, S. 1992 and S. 1993, would enable the title XI program to foreclose on its collateral. This right of foreclosure would have a 60 day waiting period.

S. 1993, drafted by the Department of Transportation, gives them an exemption from the automatic stay under Chapter 11. This, indeed, would resolve the problem where large debts are involved, such as the Maritime Administration experiences. But our programs involve many sole proprietorships and many of what have been characterized as "mom and pop" operations, which is another way of saying they are small business. These people would often qualify for reorganization under Chapter 13 of the Bankruptcy Code. Accordingly, S. 1992 will extend that same partial exemption for the title XI program to Chapter 13 reorganizations, as well as the Chapter 11 reorganizations.

We would support both of those bills, Mr. Chairman, in the Department of Commerce. We would point out to the committee that we believe it is necessary to pass both bills because if S. 1992, which deals with Chapter 13 is not passed, we believe that that would, in fact, encourage those parties who might be seeking bankruptcy under Chapter 11 and who would be also qualified under 13, to go to 13 and, thereby, place a significant portion of our portfolio under the same problem it has today, and that is a rather lengthy automatic stay.

[The statement follows:]

STATEMENT OF JAMES E. DOUGLAS, JR., ACTING DEPUTY ASSISTANT ADMINISTRATOR FOR FISHERIES, NATIONAL MARINE FISHERIES SERVICE, NOAA

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify in support of S. 1992 and its companion bill S. 1993, which would restore a right held by the Federal Government prior to 1978 Bankruptcy Code recodification. These bills would allow the government to protect its security interest in vessels financed with government guarantees when the vessel owners file for bankruptcy.

Title XI of the Merchant Marine Act of 1936 provides federal guarantees for loans for the construction, reconstruction, purchase or refinancing of commercial merchant vessels and fishing vessels. No Federal capital is involved in the origination of Title XI financings. The Program has only a contingent liability for the financings it guarantees. This contingent liability does not mature unless the financings guaranteed by the Program default.

The Program was capitalized based on the assumption that its contingent liabilities would seldom mature and when they did mature, the resulting receivables would be promptly liquidated to protect the viability of the Federal Ship Financing Fund. The Program's experience in this decade has belied this assumption, and the Program's capitalization has proven correspondingly inadequate.

The National Marine Fisheries Service administers that portion of the Title XI Program which guarantees the financing of fishing vessels and shoreside fish processing facilities. The fishing industry, like the agricultural industry, has suffered severe economic problems in the last 5 years. Consequently, defaulted financings have matured the Title XI Program's contingent liability at a rate unparalleled in the Program's history. After the Program's inadequate capitalization was exhausted in 1982, the funds to meet its matured liability had to be borrowed from the Treasury, often at historically-high interest rates.

The crucial need to promptly liquidate the Program's receivables in order to repay its Treasury debt has proven to be impossible to meet for a variety of reasons. On the average, its takes more than 1½ years from the time the Title XI Program first initiates mortgage foreclosure for the program to realize any foreclosure proceeds. One case required over 4 years. Significantly, the additional delay in this case can be traced to a Bankruptcy Court's protection for what proved to be an unsuccessful reorganization.

Bankruptcy proceedings have become a major impediment in the government's efforts to realize on its collateral. The Program's primary collateral is the fishing vessels or shoreside facilities which are financed. If a vessel owner experiences financial difficulties, the Program works with that owner to determine if the venture can be saved through deferred payments or refinancing, thus avoiding bankruptcy. If that fails and the guaranteed borrower files for the reorganization protection of a Bankruptcy Court, the Title XI Program's ability to foreclose its vessel mortgage is automatically stayed under current law pending the outcome of the bankruptcy proceedings. Thus, an inadequately-capitalized Title XI Program is required to fully redeem a guaranteed financing while being unable to liquidate its resulting receivable.

None of the 10 vessel owner reorganizations involving automatic stays under chapter 11 and opposed by the Program has resulted in a successful reorganization. They have merely postponed the inevitable and increased the Program's losses. In our experience, Bankruptcy Courts do not critically review bankrupt debtors' reorganization plans, and creditors are at a disadvantage in resisting the imposition of unrealistic plans. Additionally, vessel collateral deteriorates extraordinarily rapidly if not properly maintained. Bankrupt debtors continuing to operate Program collateral under a Bankruptcy Court's protection frequently do not properly maintain that collateral. The result can often be a vessel worth far less when ultimately available for mortgage foreclosure than it would otherwise have been without intervention of the Bankruptcy Court's automatic stay.

Prior to the 1978 Bankruptcy Code recodification, the Bankruptcy Courts could not enjoin the foreclosure of a preferred ship mortgage held by a federal agency is the foreclosure would be in the best interest of the United States. S. 1992 and S. 1993 would enable the Title XI program to foreclose on its collateral. This right to foreclose would take effect 60 days after the bankruptcy is filed, allowing the debtor and his creditors to attempt to work out their differences short of foreclosure. S. 1993, drafted by the Department of Transportation, would extend to the Title XI Program partial exemption from automatic stays in conjunction with reorganizations under chapter 11 of the Bankruptcy Code. This will resolve the problem where larger debtors are involved, such as in the Maritime Administration Title XI Program. While our Title XI Program involves some large financings it also involves many sole proprietorships and so-called "Mom and Pop" businesses. This category of bankrupt debtor often has a lower debt load which qualifies for reorganization under chaper 13 of the Bankruptcy Code. S. 1992 will extend the partial exemption for the Title XI Program to chapter 13 reorganizations as well as chapter 11 reorganizations. Because the Title XI portfolio affected by S. 1993 is so large, it is very important to correct the omission made in 1978. At the same time it is necessary to make the change for chapter 13 which is the purpose of S. 1992, so that debtors who might otherwise reorganize under chapter 11 will not try to seek to reorganize under chapter 13. The passage of both bills is therefore necessary to protect the interests of the United States when faced with attempted reorganizations.

I can assure this Subcommittee that our Title XI Program is not overly anxious to liquidate its receivables. If there is a reasonable chance that a problem financing can be resolved short of foreclosure, our Program staff is more than willing to work with the debtor. Generally, by the time a debtor under the Title XI Program seeks a Bankruptcy Court's protection, there is little reasonable chance of successful reorganizaiton.

For these reasons, we strongly support both S. 1992 and S. 1993.

Mr. Chairman, this concludes may prepared statement. I will be glad to answer any questions.

RECENT PERFORMANCE OF THE FISHERIES OBLIGATION GUARANTEE PROGRAM UNDER TITLE XI OF THE MERCHANT MARINE ACT, 1936

(1) Guaranteed financings outstanding (as of 2/28/86): [1]

[Dollar amounts in millions]

Region	Number	Total (percent)	Amount	Total (percent)
FAK/NWR	128	20.7	$75.1	44.9
FNE	117	19.0	33.6	20.1
SWR	75	12.2	14.3	8.6
FSE	297	48.1	44.2	26.4
Total	617		167.2	

[1] Does not include financings which have been redeemed or are in liquidation.

(2) Financings closed and declined (1978 through present):

[Dollar amounts in millions]

Year	Closed		Declined		Declined as a percent of amount closed
	Number	Amount	Number	Amount	
1978	177	$32.8	14	$3.9	12.0
1979	230	65.8	34	8.5	13.0
1980	229	81.2	37	16.5	20.0
1981	61	27.6	9	1.9	7.0
1982	29	16.2	7	4.8	30.0
1983	18	8.3	12	17.8	214.0
1984	28	17.6	19	5.8	33.0
1985	27	17.6	8	8.1	46.0
1986	12	10.8			
Total	811	277.9	140	67.3	

(3) Redemptions of guaranteed financings (1978 through present):

Fiscal year	Number	Amount (thousands omitted)	Number	Outstanding [1] portfolio amount (thousands omitted)	Percent redemption to portfolio	
					Number	Amount
1978			302	47,667		
1979			513	105,829		
1980	1	279	712	170,815	0.2	0.2
1981	12	3,285	748	192,166	1.6	1.7
1982	15	5,442	745	174,146	2.0	3.1
1983	23	7,789	706	193,755	3.3	4.0
1984	31	13,354	675	155,688	4.6	8.6
1985	26	4,578	621	157,980	4.2	2.9
1986	5	1,138	616	167,228	.8	.7
Total	113	35,865				

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[1] Outstanding unpaid balances of guaranteed financings after substracting redemptions.

(4) Liquidations of redeemed financings (1978 through present):

Fiscal year	Number	Amount (thousands omitted)	Number	Outstanding [1] portfolio amount (thousands omitted)	Percent redemption to portfolio	
					Number	Amount
1978			302	47,667		
1979			513	105,829		
1980	1	279	712	170,815	0.1	0.1
1981	9	261	748	192,166	1.2	.1
1982	13	5,154	745	174,146	1.7	2.9
1983	18	6,556	706	193,755	2.5	3.4
1984	16	11,552	675	155,688	2.4	7.4
1985	17	3,063	621	157,980	2.7	1.9
1986	1	422	616	167,228	.2	.3
Total	75	27,287				

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[1] Outstanding unpaid balances of guaranteed financings after substracting redemptions.

(5) Redemptions and liquidations as a precentage of guaranteed financing closed (1978 through present):

Redemptions as a percentage of closures:	
Percentage of number	13.9
Percentage of dollar amount	12.9
Liquidations as a percentage of closures:	
Percentage of number	9.2
Percentage of dollar amount	9.8

(6) Treasury borrowings:

Year:	*Amount (Millions)*
1976	0
1977	0
1978	0
1979	0
1980	0
1981	0
1982	$1.9
1983	7.1
1984	9.4
1985	2.3
1986	0
Total	20.7

(7) Fee income and administrative expense (1985):

	Millions
Income	$1.554
Adminstrative expense	(1.253)
Net income	0.301

(8) Cash flow (1977 to 1985):

Cash in:	Millions
Beginning balance	$1.5
Fees	10.3
Collection of receivables	18.8
Investment income	1.0
Treasury borrowing	20.7
Appropriation	27.0
Total cash in	79.3
Cash out:	
Administration	6.6
Redemption of defaults	35.3
CPC and advances	6.7
Repay treasury principal	20.7
Repay treasury interest	4.9
Payoff prepayment penalties	1.4
Vessels acquired but not yet sold	0.6
Adjustment	0.1
Total cash out	76.3
Net reserves	3.0

(9) Source of funds for cash outflow (1977 to 1984):

	Millions
Internal	$31.6
Appropriation	27.0
Treasury borrowing	20.7
Total	79.3

(10) Appropriations—since 1977:

Year:	Amount (Millions)
1977	0
1978	0
1979	0
1980	0
1981	0
1982	0
1983	0
1984	0
1985	$27.1
Total	27.1

(11) Present financial position—receivables discounted for projected uncollectibility:

	Millions
Cash	$3.0
Collectible receivables [1]	11.7
Acquired collateral	.6
Treasury debt	0
Equity	15.3

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[1] This is a very conservative estimate of the collectible amount of outstanding receivables. It is offered to reflect a conservative valuation of the program's present equity value.

Mr. DOUGLAS. Mr. Chairman, I think I can answer several of the statistical questions that you proposed to MarAd to give you some flavor of the nature of the problem.

We, at the present time, have 616, by number, outstanding guarantees. That comes to a contingent liability of around $167 million.

Based on the closures—by this I mean obligations that we have, in fact, closed on from 1978 through 1986—those closures were 823. In that same period of time, we have experienced 113 redemptions. Seventy-five of those have resulted in liquidations.

So, 38 have, in fact, been worked out short of an actual liquidation.

This, for perhaps ease in understanding, translates into about 13.7 percent of all of our closures during that period of time which have ultimately resulted in redemptions. The debt has gone bad.

Of those closures, 9.1 percent have resulted in actual liquidations.

Senator STEVENS. How many of them have actually gone to the bankruptcy court?

Mr. DOUGLAS. Mr. Chairman, depending on how you want to characterize that, ten where there was an automatic stay. We have had 13 bankruptcies, but not all of them have involved automatic stays.

Senator STEVENS. Of all of those, how many would this bill have affected to date if the bills you seek had been enacted?

Mr. DOUGLAS. Ten.

Senator STEVENS. Ten would have been affected?

Mr. DOUGLAS. Yes, sir.

Senator STEVENS. Thank you very much.

We appreciate your courtesy and your testimony and we look forward to your statistics, too, Mr. Gaughan.

Thank you very much.

Mr. DOUGLAS. Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question 1. As I understand it, companies in Chapter 11 continue to operate, but do not have to service their debt.

In the case of a Title XI opoerator, doesn't this enable him to undercut the market because his costs could be lower inasmuch as he would not have to service his debt?

Answer. Yes. Any competitor in the maritime industry must incur both fixed and variable costs. Fixed costs, such as capital costs, do not vary with the operation of the vessel. Variable costs, such as crew, do vary with operation. Both bankrupt and non-bankrupt competitors face essentially the same variable costs when they operate. Bankrupt competitors usually do not pay their full capital costs. Therefore, they can and do price their product below non-bankrupt competitors. This forces non-bankrupt competitors to either match the lower rate or lose business. As this continues, more operators are forced into bankruptcy, intensifying the downward spiral.

Question 2. Is the Title XI security interest of the federal government adequately protected by the automatic stay provision in the Bankruptcy Code?

Answer. No. The present Bankruptcy Code allows bankrupt companies to continue operating Title XI vessels long after they have defaulted on their Title XI obligations. Under the Bankruptcy Code, the Maritime Administration has to pay off defaulted Title XI bonds and then pursue long and arduous litigation in order to recover on its security. This process usually takes over two years.

Question 3. The Bankruptcy Code now gives partial immunity from its automatic stay provisions to ICC-regulated inland domestic vessels.

Is there any reason for giving this partial immunity to that class of vessels, but withholding it from the class of vessels covered by Title XI guarantees?

Answer. There is no valid reason for doing so. In our opinion, the Congress intended to grant this partial immunity to all vessels covered by Title XI guarantees. This anomally will be corrected by enactment of the proposed legislation.

Question 4. Chapter 11, of course, is intended to protect a debtor so that he may have time to reorganize his business, and work his way out of bankruptcy. If a debtor is deprived of revenue producing assets while he is in Chapter 11, it would, of course, be difficult for him to reorganize.

Because of this some have expressed concern about giving MARAD the discretion to foreclose on its Title XI security irrespective of the present safeguards in the Bankruptcy Act. They feel that if it is an effort to "cut the Government's losses," OMB will pressure MARAD into foreclosing in cases where the debtor has a realistic plan to reorganize.

(a) Do you believe this concern is justified, especially in view of OMB's track record of placing additional limits on Title XI guarantees?

(b) Does MARAD consult with OMB before it agrees to a plan for reorganization under Chapter 11?

Answer. (a) The Government has and will continue to accept reasonable plans of reorganization under Chapter 11 of the Bankruptcy Code. The Government does not foreclose in cases merely to cut its losses, especially where the debtor has a realistic plan of reorganization.

(b) For major plans of reorganization involving a commitment of additional expenditures by the Government, there is a collective process among MARAD, the Office of the Secretary of Transportation, the Department of Justice, and OMB.

Question 5. The Administration has said it will submit legislation to eliminate the Title XI program, and OMB now has a $70 million limitation on new guarantees for this year.

Since the Administration wants to eliminate the program, and obviously intends to keep new guarantees to a minimum in the meantime, it doesn't appear that the Government's exposure on any new Title XI guarantees will be very large; unless, of course, MARAD wants S. 1992 and S. 1993 to apply retroactively to current Title XI mortgagors who are now in bankruptcy or may hereafter file.

Should this legislation be retroactive; and if so, couldn't it jeopardize companies now in Chapter 11 working their way out?

Answer. It would obviously be in the best financial itnerests of MARAD if the legislation were retroactive and MARAD could recover, in appropriate cases, against defaulted assets now protected from foreclosure by the stay of various Bankruptcy Courts. However, application of the legislation to existing Chapter 11 bankruptcy proceedings would be most difficult, as they have progressed to various stages. Therefore, the Administration is not seeking application of these bills to existing Chapter 11 bankruptcy proceedings.

Question 6. With respect to Title XI operators in Chapter 11, what percentage of them have been able to successfully reorganize and come out of Chapter 11?

Generally speaking, how long does it take for a company in Chapter 11 to reorganize and come out?

Answer. Only one Title XI operator has successfully reorganized under Chapter 11, Waterman Steamship Company. It took about 2½ years from date of filing.

Question 7. This morning the Committee will hear testimony that: "In one case, an oilfield service vessel company filed for Chpater 11 protection and defaulted on their MARAD loans, then continued to operate with the apparent sole purpose of allowing the owners to avoid recapture of Investment Tax Credits and accelerated depreciation tax credits they had received through the venture."

To your knowledge, does this occur often in Chapter 11 cases?

Answer. MARAD is not qualified to speculate on the broad spectrum of bankruptcy cases. However, we are aware that shipping transactions are captial intensive and involve substantial tax benefits that involve large recapture potentials. MARAD believes that the retention of tax benefits was a major motivation for some shipping companies that have filed for Chapter 11 protection. Our views are based on statements made to us by a number of shipowners who had defauted on their Title XI debt.

Question 8. In the 97th Congress, at the Administration's request, the Committee reported a much more narrowly drafted bill which would have limited the exception to the automatic stay provisions to the federal government's Title XI interest. Why is the Administration now requesting a much broader exception which includes private secured interests?

Answer. The Administration's request is based upon the following:

(a) The legislative history of the Bankruptcy Act of 1978 indicates that Congress intended to provide a partial exemption from the stay for both governmental and private parties under section 1110. There was no indication that Congress was or would be receptive to the creation of a special right for the Government. In an attempt to stay within the intent and philosophy of the 1978 Code, the Department proposed S. 1993. The Department was concerned that its legislation not be perceived as special interest legislation.

Question 9. The national interest in trying to give maximum protection to the federal government's secured interest in bankruptcy proceedings is, I believe, apparent.

What is the national interest in extending that protection to the secured interest of private parties as S. 1992 and S. 1993 would do?

Answer. We have no objection to an amendment to these bills whereby the protections being sought are restricted only to the United States' security interests. We believe that the benefits of the Title XI program have been and are unique, and that it is not unfair to limit these protections to the United States. We simply were attempting to propose legislation that was as much as possible compatible with the present Bankruptcy Code.

Question 10. On the average, how lengthy are the court proceedings to lift the automatic stay proceedings under the Bankruptcy Code?

Answer. The average length of time between the Government's motion to lift the stay and relief from the stay in Title XI bankruptcy cases is 18.6 months. The following is a general example of the steps involved that result in this inordinate delay. If a defaulting Title XI shipowner files for reorganization in bankruptcy under Chapter 11 of the Bankruptcy Code, stay provisions automatically prohibit any creditors from taking action against the operator or the vessel until the bankruptcy court affirmatively lifts the stay. There are two grounds for an order to obtain relief from the automatic stay: (a) cause, including lack of adequate protection or (b) the debtor has no equity in vessels and the vessels are necessary to an effective reorganization. While under the protection of the bankruptcy court, the shipowner may continue to operate the Title XI vessels. The Department of Justice (DOJ) enters an appearance in the Bankruptcy Court on behalf of the Secretary of Transportation (Secretary). The DOJ Moves the court for relief from the stay. Lengthy discovery may occur prior to a hearing conerning relief from the stay. Continuations frequently occur, and delays arise over possible reorganization plans. In theory, bankruptcy law provides that once a motion for relief from a stay is filed, a creditor should obtain a judicial adjudication within ninety days. The Code specifically provides that thirty days after a request for relief is filed, such stay is terminated, unless the court, after notice and a hearing (a preliminary hearing), orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination. The reality of practice is far from the theory. When preliminary hearings are held, they may not be held within thirty days of filing. At such hearings it is rare that any evidence is taken and it is highly unlikely that a

judge will not continue a matter to final hearing. Congested judicial calendars make it difficult in certain courts to obtain a final hearing within thirty days of the preliminary hearing. Once a final hearing has been held, a judicial decision is not likely to be obtained within thirty days. Assuming a favorable bankruptcy court decision, that decision may be appealed to the district court and the bankruptcy court may stay its relief order. A favorable district court decision may be appealed to a circuit court and the original relief order stayed. Alternatively, an unfavorable district court decision to the shipowner may be remanded, with delays and possible appeal arising from the remand order.

Senator STEVENS. Our next witnesses are Sharon Meadows, vice president, First Boston Corporation, and Lawrence P. King, professor of law at New York University School of Law, on behalf of the National Bankruptcy Conference.

Good morning.

Ms. Meadows, you are first on my list.

STATEMENTS OF SHARON M. MEADOWS, VICE PRESIDENT, FIRST BOSTON CORPORATION; AND LAWRENCE P. KING, CHAIRMAN, COMMITTEE ON LEGISLATION, NATIONAL BANKRUPTCY CONFERENCE

Ms. MEADOWS. Good morning, Mr. Chairman.

My name is Sharon Meadows. I am a vice president of the First Boston Corporation, which is a major New York investment bank. I am a member of First Boston's restructuring and reorganization group, and I have spent the last ten years dealing with companies in financial difficulty, both in and out of bankruptcy.

We have been asked to provide commentary on the issue in front of this subcommittee with regard to whether or not the passage of this legislation would have a negative impact on the ability of companies to reorganize in Chapter 11, and whether or not the passage of this legislation would have a negative impact on other creditors in certain of these situations.

I should point out at the outset that First Boston has represented companies which have an interest in this matter, including companies which have had, as part of their creditor group, the Maritime Administration.

To summarize my testimony, I would say that the passage of this legislation could, in fact, inhibit the prospects for reorganization and rehabilitation in the event that a company encounters financial difficulty resulting in a Chapter 11 proceeding. It could also have some unexpected effects on the ability of companies to raise capital in the public and private markets.

The reasons for my belief are as follows.

My first assertion would be that certain Chapter 11 reorganizations are impossible if one creditor has the right to foreclose on assets in preference to other creditors.

The parties of interest in a bankrupt entity consist of several classes, each with a different claim priority, such as secured creditors, unsecured creditors, preferred shareholders and common shareholders.

The Chapter 11 process is designed to allow a debtor to reorganize and attempt to give value to all of these parties of interest.

The key provision of the Bankruptcy Code that enables a company to reorganize is the automatic stay. In other words, a secured lender cannot simply take its collateral, exit the proceeding, and go home.

There are frequent cases where the primary productive assets of a company are, in fact, pledged to lenders. The withdrawal of these assets would prohibit a company from operating and prevent it from providing any value to nonsecured parties of interest.

The ability of one secured creditor to foreclose on assets in preference to other secured creditors also distorts the distribution of values of the company. The foreclosure of assets eliminates part of the corporation, potentially to the point of reducing other collateral values.

My second assertion would be that the ability of one creditor to interrupt a business by foreclosing on assets may cloud that business' ability to attract outside investment.

The willingness of financial institutions and private investors to commit capital to a company depends on many factors. Among these factors are the expected rate of return from the investment, potential growth prospects for the company, the perceived risk of default on the investments, and so on.

Implicit in the investment decision is the expectation that creditors will be treated in trouble on a pari passu basis with other creditors of a similar class, and that if a bankruptcy ensues, the assets available to each class will be shared equitably.

If a potential investor in a company which owes title XI debt perceives that a bankruptcy proceeding will result in an untimely liquidation because one creditor can remove essential assets, that investor may either avoid such a company altogether or demand a rate of return that is higher than the company might expect to pay under normal circumstances.

For already issued securities of companies in depressed industries, the consequences may be similarly negative. An industry collapse, such as we are now experiencing in the offshore drilling and shipping businesses is signaled by precipitous drops in the trading values of the public securities issued by participants in the industry. If all public bond holders are not provided with the same rights, the values of these public securities may be even further impaired.

My third assertion is that creditors' best interests are generally served by the rehabilitation of a debtor company rather than by its liquidation.

Creditors' best interests are served when they recover the largest percentage of moneys owed to them on a present value basis. The ability of creditors to fully recover what is owed to them is almost always better if a debtor is allowed to rehabilitate and become viable over the long-term. Liquidation values or current market values are usually low for a troubled company for several reasons.

If a company is operating in a depressed industry, it is unlikely that its assets will have much market value because there will be few investors in the industry.

Troubled industries are frequently plagued by over-capacity, which serves to depress prices for assets. You touched on this in your examination of the previous witnesses.

Many of a company's assets only have going-concern value—for example, pieces of a plant have no value except for scrap; the operating plant has the value of its expected future cash flows, but only if that company is held together and allowed to generate those cash flows.

When a company is allowed to rehabilitate itself over time, going-concern values can be realized. A company can reorganize around core, profitable businesses; liabilities are restructured to match expected cash flows; the industry itself may strengthen; and the company may have the ability to return to long-term health, thereby benefitting all creditors and shareholders.

Employment is provided by the revitalized company and it again begins to contribute tax revenues to State, municipal, and Federal authorities.

My fourth assertion is that the ability to restructure outside of a Chapter 11 proceeding may be lost if the automatic stay is not applicable to all creditors.

A Chapter 11 proceeding is disruptive to both the company and its creditors. There are very few companies with which I have had any experience who have willingly entered a Chapter proceeding. It is not something that companies do without serious consideration and without feeling that there are very few other alternatives to them.

Therefore, a company and its creditors frequently choose to do a restructuring out of court, avoiding the costs of a Chapter 11 proceeding. The basis of this attempt to restructure out of court is the knowledge on both sides that if the company enters Chapter 11, the automatic stay in invoked.

There is generally an implicit understanding between the company and the creditors that if a secured creditor moves against collateral, the company will file for bankruptcy so as to protect its assets. This is a powerful and important negotiating tool used to encourage out of court restructurings, which are less costly to both creditors and shareholders.

Finally, I would assert that the Bankruptcy Code already provides for adequate protection for all secured creditors.

The Bankruptcy Code incorporates the concept of adequate protection which is designed to maintain the value of collateral for creditors while a debtor continues to use collateral during the reorganization proceeding.

The Bankruptcy Code provides that the debtor must maintain the value of secured assets during the Chapter 11 proceeding, and in some instances courts may require the equivalent of interest payments to be paid on the collateral value.

Theoretically, then, as long as a company has some assets available to it, secured creditors do not risk the value of their collateral while a company reorganizes.

The conclusion of my testimony, therefore, is that the Bankruptcy Code is designed to foster rehabilitation of failing companies and to maintain relative priorities among creditors. This legislation could potentially undermine both these concepts, leading to more business failures, costly fire sale liquidations, loss of employment, and loss of potential tax revenues from debtors who successfully reorganize their businesses.

Through the concept of adequate protection, the code attempts to safeguard the interests of secured creditors, while permitting an equitable and orderly reorganization.

Recent experience in major Chapter 11 cases has confirmed the theory that liquidation values are generally inferior to those obtainable in a reorganization. Therefore, it may not necessarily be in the best interests of a secured party to foreclose on collateral.

This legislation could render some companies unreorganizable and could increase capital raising costs for others.

That summarizes my comments, Mr. Chairman. I would be happy to answer any questions that you may have.

Senator STEVENS. Thank you.

[The following information was subsequently received for the record:]

Senator STEVENS. Do you have much to do with those companies in difficulty who really do attempt to reorganize?

Ms. MEADOWS. Yes.

First Boston has represented quite a few Chapter 11 debtors who have successfully reorganized.

Senator STEVENS. Do I understand your statement to mean that there would be a disincentive to people to participate in a Chapter 11 proceeding if this remedy sought by the government in these two bills was available?

Ms. MEADOWS. The concern is that if certain assets, which may be the most productive or the most necessary assets in the company, can be removed, it is not just a question of creditors being willing to participate in a Chapter proceeding, it is whether or not there is the ability, then, to reorganize the company if these assets are removed.

Senator STEVENS. Do you have any feeling about the cyclical effect of some industries? For instance, with the oil price down right now, obviously drilling rigs are going to go into default and to a certain extent procedures that are available at times would seem to enable some of the entities to survive a cycle because they can literally delay through to the upswing and then recover. Is that a valid perception of what goes on in these proceedings?

Ms. MEADOWS. That is a perception that we have with regard to cyclical industries. The over-capacity in the drilling industry right now is so severe that it is difficult for us or anyone else to predict whether these companies will ever be able to use all this equipment again. But, with cyclical industries in general, I would say that that is a valid statement.

Senator STEVENS. Thank you very much.

We appreciate your taking the trouble to make comments on these bills, Ms. Meadows.

Mr. King.

Mr. KING. Thank you very much.

I will not repeat what Ms. Meadows has said with respect to some of the basic purposes of Chapter 11 of the Bankruptcy Code and of other provisions in the Bankruptcy Code. I think that she expressed them very well.

I am here representing the National Bankruptcy Conference. My written statement indicates the makeup of that conference and its purpose, and I will not go into that either.

But I think I ought to say that I don't know anything about the maritime industry. My experience has been more in the teaching and lecturing and writing in the field of bankruptcy over the last 27-some-odd years.

There are a couple of points I would like to focus on, with respect to the Bankruptcy Code and some of the legislation that existed prior to the present Code.

I have heard this morning that the changes that were made in the 1978 code with respect to maritime liens and preferred ship mortgages were inadvertent, accidental, or unintentional. I am not quite sure where that conclusion comes from. My recollection is—and I have contained some of this in my written statement—that there are at least three instances that one can point to to show that Congress quite intentionally affected the status of the government as a debtor, secured or unsecured, in bankruptcy proceedings.

For example, prior to the 1978 code, section 64a(5) of the Bankruptcy Act of 1898 gave to the Federal Government a fifth priority for non-tax debts. I'm not even talking about taxes. Taxes had a higher priority, and they still do. But for non-tax debts owing to the Federal Government, there was a fifth priority in payment that it was entitled to, and in the case of a Chapter 11 proceeding under the old Bankruptcy Act, because it had that priority and was entitled to be paid ahead of all other unsecured creditors, the Government, therefore, had to be paid in cash on confirmation of a Chapter 11 plan.

That was quite a priority—forgetting about a Chapter 12 liquidation case. We are not even talking about that. This is just in a reorganization or an arrangement case.

That priority was intentionally deleted in the 1978 code by both the House and the Senate Judiciary Committees. The committee reports amply indicate that the theory was, pursuant to a study made by a Congressional commission, the Commission on the Bankruptcy Laws of the United States, that there was no longer a valid purpose to place the Government ahead of other creditors who also loaned money, gave supplies, or gave services to a debtor which later found itself in financial difficulty.

Point number two, concerns a section that was referred to earlier this morning, section 1110 in the code, how did that section come about in its present version? Actually, the present version is similar to the version that existed under former Chapter 10. There are two interesting things.

One is it existed under ection 116 of Chapter 10 of the former Bankruptcy Act. It did not exist at all in Chapter 11 of the Bankruptcy Act. Only in Chapter 10, only if there were a corporate reorganization was there this very, very special, but very limited, preferred treatment given to conditional vendors of aircraft. Coverage of limited kinds of vessels came about in 1967 or thereabouts.

When the 1978 code or the predecessor bills were being drafted that led to the 1978 code, there was no provision comparable to section 1110. This preferred treatment had been deleted from those bills, but pursuant to some heavy lobbying by equipment manufacturers, it was put back in very limited fashion as we now find it in section 1110.

So, in that sense, too, the original contemplation of the Congress was to delete section 1110 in its entirety. It only came in because of some heavy lobbying effort, as I say, and then in a very limited fashion.

The purport of the pending bills, as I understand them, would be to broaden quite extensively the scope of section 1110, which will lead to all the things Ms. Meadows was talking about.

Thirdly, and most importantly on this point, to say that the Government with a maritime lien or preferred ship mortgage could not have been stayed by a bankruptcy proceeding I think is not quite accurate under the former bankruptcy law. It is true that in Chapter 14 of the Bankruptcy Act of 1898, there was a section, section 703, which did say exactly that. However, from 1974 on up to the Bankruptcy Reform Act of 1978, there was in existence Chapter 11, rule, 11-44; there was a similar rule for Chapter 10 proceedings; there was a similar rule for liquidation proceedings. These rules constituted an automatic stay against lien enforcement. As a matter of fact, those rules were the predecessor rules or provisions to what we now find in section 362 of the code.

These rules superseded section 703. There was not, therefore, the automatic right of the Government to foreclose when there was a Chapter 11 or a Chapter 10 proceeding under the former act.

Moreover, and I will conclude on this point, as my supplemental statement indicates—and I will not read the quote there—Senator DeConcini, was the floor manager of the 1978 code when it came up for a vote in the Senate, and Congressman Edwards held the same position in the House—they are quoted in my statement from the *Congressional Record* in which they say that section 703 of the former Bankruptcy Act is subject to the repeal of the former Bankruptcy Act. The two preceding sections in Chapter 14, having nothing to do with the stay, having only to do with the right of the administrator with respect to conducting a proceeding or paying out funds to creditors to keep the company or the vessel going, were put into the Merchant Marine Act. They were taken out of the Bankruptcy Act and were not carried over into the 1978 Bankruptcy Code.

But section 703 was not put into the Merchant Marine Act. It was not carried over into the 1978 Bankruptcy Code. It was purposely left out, because they said, and I am quoting just this one line, "Reinstituting an absolute right for an agency of the government to seize vessels is unwise and unnecessary."

So, to say that it was an inadvertent omission I think is not quite right.

I agree, and urge the committee, number one, to consider the dire effect that this legislation can and will have, without doubt, on the possibility of reorganizing, and certainly on the possibility of losing whatever latent going concern value such a company might have.

Thank you very much for your attention. If you have any questions, I will be glad to try to answer them.

[The statement follows:]

First Boston Corp.,
Park Avenue Plaza,
New York, NY, March 25, 1986.

John D. Hardy, Esq.,
Democratic Merchant Marine and Tourism Counsel, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

Dear Mr. Hardy: In response to Senator Inouye's question regarding the likelihood that companies will operate the Chapter II simply to avoid ITC recapture problems, I would answer that a company can only continue to operate in the long run if it is generating sufficient cash flow to pay employees, purchase materials, etc. Even if a company desired to operate solely for investor tax avoidance purposes, it cannot do so unless it is also making sufficient money to stay alive in an operating mode. Therefore, I would conclude that very few, if any, companies make their operate vs. shutdown decisions on the basis of tax consequences. I will also say, however, that I am not familiar with the case which was mentioned in testimony.

With regard to the second question about immunity from the automatic stay for ICC-regulated inland domestic vessels, I will defer to my fellow panelist, Professor King, as this is more a legal than a business question.

I'd be pleased to provide you with any other commentary which would be helpful to the Senator.

Best regards.

Sincerely,

Sharon M. Meadows,
Vice President.

STATEMENT OF LAWRENCE P. KING, ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE

The National Bankruptcy Conference ("Conference") appreciates the opportunity to present its views on S. 1993. The Conference is a voluntary, private, nonprofit organization composed of members of the federal judiciary, lawyers and lawyers professors whose professional background and experience has been and is devoted to the area of the federal bankruptcy law. The sole purpose of the Conference is to assist the Congress in the improvement of the bankruptcy law and its administration. The Conference has been in existance since the mid-1930's; it both proposes and reacts to legislation amending the Bankruptcy Code proposed by others. The Conference has about 65 members who are drawn from the various geographic portions of the United States.

The Conference does not favor the passage of S. 1993 because it will obstruct rather than further the reorganization process contemplated by chapter 11 of the Bankruptcy Code (11 U.S.C. §§ 1101 *et seq.*), and because it represents private interest legislation in derogation of a basic concept of the Bankruptcy Code that creditors or similar classes should be treated alike.

POTENTIAL IMPACT OF OFFSHORE ENERGY EXPLORATION

The proposed legislation, if enacted, will apply to, *inter alia*, offshore drilling rigs. It is suggested that the legislation is necessary and will benefit the United States Treasury and taxpayers by enabling the Maritime Administration ("MarAd") to realize revenues from offshore drilling rigs that were financed through the title XI program of the Merchant Marine Act. It is believed that MarAd assisted in the financing of over 50 offshore drilling rigs, many of which are operating in the Gulf of Mexico. In the usual format, MarAd guaranteed payment of obligations to other entities, who actually advanced the financing for the construction of the rigs. Upon default, the MarAd guarantees are called and MarAd steps into the shoes of the creditors and succeeds to the lien position of such creditors. Alternatively, there is an offering of notes which are guaranteed by MarAd and the regular owner amortization and interest payments to MarAd for distribution to the noteholders.

The sponsors of the proposed legislation submit that such legislation will enable MarAd either to obtain the debt service associated with the financing of a particular rig or rigs or realize upon the collateral security. An amendment to the Bankruptcy Code to pub MarAd and similarly situated ship mortgage creditors within the protection of section 1110 of the Bankruptcy Code will not attain the objectives claimed by the sponsors of the legislation.

Because of the state of the offshore drilling industry, debtors will not be able to make debt service payments in accordance with existing debt instruments. Accordingly, MarAd will be allowed to reponsses the offshore drilling rigs. If that should occur, then MarAd will have only three alternatives:

1. Sell the offshore drilling rig at a distress "fire sale" price.
2. Lay up or stack the offshore drilling rigs to await an uptrun in market prices.
3. Attempt to employ the offshore drilling rig itself or through a managing entity.

Each of the three alternatives listed above does not accomplish a beneficial result for MarAd. In the first case, an auction sale of the offshore drilling rigs repossessed will yield minimal returns in the current economic environment. The effect of such sales will be to further destabilize the offshore drilling market. A purchaser of a rig at a distress price may, in turn, offer that rig for leasing at substantially lower day rates, which would become the lowest common denominator in the offshore drilling market. This would have the effect of causing other offshore drilling companies to lose additonal moneys and, in all likelihood, compel those entites either to seek relief under the Bankruptcy Code or, in the context of the proposed legislation, simply surrender their MarAd-financed rigs to MarAd and cause additional fire sales with attendant consequences. The loss to the taxpayer and to the public at large is significant.

The second alternative is no more palatable. The costs of stacking and laying up offshore drilling rigs is very substantial. If all of the MarAd-advanced offshore drilling rigs were to be stacked, the cost would exceed $50 million per annum, or approximately $1 million per rig. Further, maritime equipment is particularly sensitive to deterioration. As a consequence, startup costs would be substantial and might lead to the conclusion in the future, after expenditure of substantial storage charges, that the best option for MarAd is to scrap the collateral security. Again, the costs to parties in interest, including MarAd, is substantial.

The third alternative would mean more out-of-pocket government expense. The current economic climate in the maritime industry and, in particular, the offshore drilling industry, would require substantial advances on the part of MarAd if it elected to operate the offshore drilling rigs, even if a managing entity were to be employed. The cost of that entity would have to be absorbed. No rational entity would agree to assume the costs of operations in this market environment.

In the context of the above, and the underlying philosopy and public policy of the reorganization provisions of the Bankruptcy Code, it is almost irresistible that the best course of action to follow is to allow offshore drilling companies the opportunity to seek the relief that may be obtained through a reorganization case. That relief may benefit the nation, the creditors, and the shareholders. It does not mean that MarAd and similar entities are without remedies. The protective provisions of the Bankruptcy Code, such as §§ 361, 363 and 364, serve to protect the interests of MarAd in the same manner as the Supreme Court and the Court of Appeals for the Second Circuit observed that such provisions protected the Internal Revenue Service as a secured creditor in the *Whiting Pools* case, *infra.*

The proposed legislation would significantly increase the probability that every chapter 11 reorganization of a United States ship owner or rig operator will become a liquidation case. MarAd is the largest lender to the U.S. flag fleet. Under the proposed legislation, *it and all other U.S. vessel lenders* would be allowed prematuraly to repossess the vessels, equipment, and rigs it debt service payments are not resumed as contemplated by the proposed legislation. It is simply unrealistic to believe that debtors who have just found it necessary to seek relief under the Bankruptcy Code will be able resume debt service payments.

Consequently, the proposed legislation would deprive the U.S. Merchant Marine and offshore energy industries of the basic ability to attempt to protect the intertests of all parties by reorganizing a financially distressed business throught the use of the procedures and provisions of chapter 11 of the Bankruptcy Code. The proposed legislation, as applied to the shipping industry, will deprive that industry of the ability to deal with cyclical market downturns because there will be no option available other than liquidation. Whatever latent going-concern values that might exist and which would be realized by the inevitable market upturn will be lost by the related creditors and other parties in interest.

Of course, the potential retroactive application of the proposed legislation can be disastrous to offshore drilling companies and shipping companies that may have been compelled to seek and are undergoing relief under chapter 11 as of this time. Those include Global Marine Inc. and its subsidiaries. Enactment of the proposed legislation undoubtedly will turn the pending cases into liquidation cases, with all of the concomitant drawbacks to such a process.

THE PROPOSED LEGISLATION IS SPECIAL INTEREST LEGISLATION

The enactment of the proposed legislation would be inimical and prejudicial to the proper administration of the federal bankruptcy and recorgization laws. It affords special protection to a special interest group. It would also have the effect of emasculating the fundamental debtor protection provided by the automatic stay.

When the governmental exceptions to the automatic stay were debated in the Congress (section 362(b)(4) and (5)), the limited scope of those exceptions was underscored by the statements made by the managers, of the Bankruptcy Reform Act of 1978:

"This section is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and *not to apply to acts by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate.*" 124 Cong. Rcd. No. 11,092 D.Ed., Sept. 28, 1987. (Statement of Rep. Edwards); (124 Cong. Rcd. S.17,409, D.Ed. Oct. 6, 1978); (Statement of Sen. DeConcini). (Emphasis supplied).

Thus, Congress considered and concluded that the pecuniary interests of the Federal Government should be subject to the automatic stay provisions of section 362. This was emphasized in the decisions in *In re Whiting Pools, Inc.*, 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983).

Obviously, once the door is open, others will attempt to slide through or push the door open wider. Enactment of the proposed legislation may well lead to basic change in the philosophy of U.S. bankruptcy law. Other types of secured creditors will seek similar-type legislation. As a result, it may ultimately come to pass that all secured creditors are excepted from the application of the automatic stay and bankruptcy courts directed by statute not to interfere with the rights of secured creditors in or against collateral security granted by debtors. This would constitute a repudiation of all that was done in the formulation of the Bankruptcy Reform Act of 1978 and, indeed, the legislative amendments of 1984.

It is worth noting that under the now repealed Bankruptcy Act of 1898, former section 64a(5) granted the Federal Government a fifth priority in payment of nontax debts owing to it. This priority for the Federal Government for nontax debts was eliminated by the 1978 Bankruptcy Code. The Commission on the Bankruptcy Laws of the United States, established by Congress in 1970 to study the bankrupty laws with a view of revising them in light of changed circumstances since their promulgation in 1898, recommended that the notax priority of the Federal Government be abolished.

"As to nontax claims of the United States, the policy of equal treatment of creditors is not outweighted by any sound justification for continuing this offspring of the 'ancient prerogative of the English Crown.'

"* * * "The temendous expansion of federal-financing programs since the priority of nontax claims in bankrupticy was restored by Congress in 1926 compels reconsideration of whether it is sound government policy to attempt to bolster the economy by federal loans and guaranties, frequently involving marginal debtors, and at the same time to discourage uninsured credit by making it more hazardous. The 1970 ABA proposal—making a bold but justifiable step forward from its 1959 recommendation—would accordingly limit the federal priority in insolvency and bankrupty to tax claims." Report of the Commission on the Bankruptcy Laws of the United States, Pt. I, pp. 217-218 91973). The Report also quoted from *Davis* v. *Pringle:*

"No sound principle of public policy can be invoked in support of preference to the federal government * * * over citizens in the collection of ordinary debts. On the contrary, the contractual operations of the federal government * * * have become so extensive and so involved with the business of private citizens that priority to the federal government * * * except for taxes, would operate as an oppressive hardship on other creditors of bankrupts." 1 F.2d 860, 864 (4th Cir. 1924), *aff'd,* 268 U.S. 315 (1925).

The Commission's recommendation to abolish the Federal Government's nontax priority, obviously, was accepted by Congress when it enacted the 1978 Bankruptcy Reform Act. In explaining the deletion of the priority from H.R. 8200, the forerunner of the Bankruptcy Code, the House Judiciary Committee wrote:

"The more major priority set aside is the Federal, State, and local governments' nontax priority, and the Federal priority established in the Revised Statutes. The chorus calling for repeal of that priority in bankruptcy cases has grown in recent years [citing Plumb, *The Federal Priority in Insolvency: Proposals for Reform,* 70 Mich. L. Rev. 1, 71-79 (1971)]. One organization even suggested that the government's nontax claims be subordinated to general unsecured claims, because most of the governments' claims resulted from various social programs that the Congress had agreed to fund, and that therefore the government should not compete with other creditors who had extended credit for business, not social welfare reasons. H.R. 8200 does not go so far, but simply places the government's nontax claims on a parity with other unsecured claims, unless, of course, the government's claim is secured. The time has passed when the sovereign can do no wrong and is entitled to the first fruits of every insolvent estate." House Report No. 959, 95th Cong., 1st Sess. 193-194 (1977).

The effect of the pending bills would be to place the Government in an even better position than under the 1898 Bankruptcy Act. Instead of a fifth priority claim, the Government would have a secured claim entitled to immediate and full continuing payment or right to foreclose making reorganization not only unfeasible but practically impossible.

The proposed amendment to chapter 13 is not sound. Even in the case of chapter 13, there is no reason to single out the Federal Government for special treatment. Such treatment can easily work to the detriment of other creditors, secured and unsecured, by locking up the available funds that a chapter 13 debtor may have from future income.

Without any amendments to the Bankruptcy Code, the Government has the protections afforded by it to all secured creditors. Thus, while the automatic stay of section 362 is applicable to prevent foreclosure by the Government without permission of the court, the Government is entitled to be adequately protected against loss caused by the debtor's continued use of the collateral. Sections 362 and 361. In a chapter 11 case, the Government as secured creditor has all of the protections afforded by sections 1129(b), requiring full payment if it does not accept a plan of reorganization, 1111(b), permitting it to opt to be fully secured even if the collateral has a lesser value, and 1124, requiring its rights to be recognized or to receive payment in cash in full if the debtor elects to treat the Government's claim as unimpaired.

CONCLUSION

The Federal Government should be treated the same as other creditors in the event a debtor files a petition for relief under the Bankruptcy Code. S. 1993 and S. 1992 would change the basic structure and balance so thoughtfully constructed in the 1978 reform legislation. This type of piece-meal tampering with a Code that took Congress some years to put together after thousands of pages of testimony from witnesses involved in all facets of insolvency problems can only lead to rendering the relief fashioned by Congress unrealistic and unavailable. The National Bankruptcy Conference urges this Subcommittee not to approve the bills.

SUPPLEMENTAL STATEMENT

As indicated in its main statement, the National Bankruptcy Conference opposes S. 1993 and S. 1992. There are two additional points it wishes to make in this regard.

(1) Prior to the 1978 Bankruptcy Code, Chapter XIV of the Bankruptcy Act of 1898 was entitled "Maritime Commission Liens". (11 U.S.C. §§ 1101-1103.) It was composed of three sections, the first two of which have been carried over into Title IX of the Merchant Marine Act, 1936 (46 U.S.C. §§ 1241 *et seq.*), at section 908. Those two sections specified the role of the Maritime Commission, since changed to the Secretary of Commerce, when a corporation operating a vessel under United States registry was a debtor in a proceeding in which a receiver or trustee may be appointed. These sections are not pertinent to the present discussion.[1]

The third section, (§ 703 of the Bankruptcy Act or 11 U.S.C. § 1103) provided that the bankruptcy court could not enjoin the United States as a creditor under a preferred ship mortgage. This section was purposely and intentionally not carried forward in the 1978 legislation or in any other statute of the United States. It was meant to be covered by the repeal of the Bankruptcy Act of 1898. Section 703 had been promulgated before the first of the automatic stay rules contained in the Federal Rules of Bankruptcy Procedure. The first set of rules was promulgated and became effected in 1973, applying to liquidation cases under Chapters I-VII of the Bankruptcy Act of 1898 and to Chapter XIII wage earner cases. In subsequent years, rules were promulgated to cover Chapter IX, X, XI and XII cases and each set from the beginning contained at least one rule that created an automatic stay of lien enforcement which became effective on the filing of a petition commencing a case under the Bankruptcy Act. These rules were promulgated by the Supreme Court of the United States pursuant to the rulemaking power granted it by Congress in 28 U.S.C. § 2075. Congress also had supervisory control because the rules did not become effective until Congress had an opportunity to change or veto them. "It was thus clear that these automatic stay provisions [by their terms] superseded Section 703." 1 *Collier, supra,* at 5-146.

While sections 701 and 702 of former Chapter XIV were replaced in the Merchant Marine Act, section 703 was not. It was recognized that giving an agency of the Government the unfettered right to enforce liens, *i.e,* to seize vessels, was both unwise and unnecessary. See 1 *Collier, supra,* at 5-147. The comments of Senator DeConcini and Congressman Edwards, the floor managers of the 1978 bankruptcy legislation, are instructive:

"Section 334 of the House amendment is identical with a provision contained in the House bill and Senate amendment. The bill codifies chapter XIV of the Bankruptcy Act, as amended by the Rules of Bankruptcy Procedure. Prior to adoption of the Rules of Bankruptcy Procedure, the Maritime Administration had a right to repossess vessels notwithstanding any contrary order of the court under section 703 of the Bankruptcy Act. The automatic stay contained in rules such as chapter XI rule 11-44 superseded that provision. Reinstituting an absolute right for an agency of the Government to seize vessels is unwise and unnecessary. The new concept of adequate protection contained in section 361 of the House amendment may be demanded by a creditor as a precondition to use of collateral under section 363(e) of title 11. Moreover, in a case under chapter 11 of title 11, a secured creditor or lessor of a vessel is entitled to repossession after 60 days under section 1110 of title 11, unless the trustee or debtor in possession cures all prior defaults and gives adequate assurance of future performance. Surely it is reasonable for a debtor in possession to be afforded such an opportunity to rehabilitate a business that may have a dramatic impact on the public interest. A governmental agency should not be able to engage in unilateral action to protect pecuniary rights and thereby imperil the public good." 124 Cong. Rec. S17,426 (daily ed. Oct. 6, 1978); H11,109-11,110 (daily ed. Sept. 28, 1978).

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[1] "It was the view of both the Senate and the House Judiciary Committees that this addition to the Merchant Marine Act of 1936 did not govern bankruptcy proceding and therfore, was 'more properly poaced in the Merchant Marine Act than in proposed title 11 of the United States Code.'" 1 *Collier on Bankruptcy,* ¶ 5.34 (15th ed. 1980) quoting from S. Rep. 989, 95th Cong., 2d Sess. 165 (1978), H. Rep, 595, 95th Cong., 1st Sess. 458 (1977).

Clearly, Congress was cognizant of what it was doing in the repeal of section 703. It should not be reinserted by whatever means at least without thorough study by those familiar both with the industry and the workings of the bankruptcy law system. As mentioned, the 1978 Bankruptcy Code has, for the debtor in possession's benefit, a built-in automatic stay to prevent secured creditors from enforcing liens without court approval. Section 362. However, for the creditor's benefit, the Code provides in sections 362 and 361 that the secured creditor must be adequately protected against loss caused by the debtor's continued use of the collateral. What constitutes adequate protection is exemplified in section 361 and the court had flexibility in approving that which a debtor in possesion fashions under the exigencies of the particular case. Amending section 1110 and broadening its coverage would displace ths care-balancing of interests that Congress worked so hard to accomplish in the late 1970's.

(2) The second point is related to the first one set out above. As indicated, there are various section in the 1978 Bankruptcy Code that recognize the interplay among the debtor, secured creditors and unsecured creditors. Two sections were mentioned above. Others include section 363 which permits the debtor in possession to use, sell and lease property of the estate in or out of the ordinary court of business. This is a salutary feature in that it assists in the reorganization prospects of a chapter 11 debtor. On the other hand, if another party has an interest in such property, such as a lien, on objection of that party, the debtor in possession must offer to adequately protect that person against loss. Another section 364 which recognizes that a debtor in possession undergoing an attempt at reorganization, may well need the infusion of new financing to maintain its business operations, *e.g.*, meeting a payroll. Section 364 provides a means or incentives for lenders to finance a chapter 11 debtor by giving such lenders administration expense priorities, liens on free assets, superpriorities ahead of other administration expenses, and even liens that may prime prior liens. In the last instance, however, the existing lienholder must again be adequately protected against loss.

The point is that much thought has gone into the drafting and promulgation of the Bankruptcy Code. Suggested amendments should go through the established legislative process so that those most familiar with the workings of the Code can put their expertise to evaluating the proposals. The established procedure in the instant matter means the Judicial Committees of both the Senate and the House. Bankruptcy legislation is within the purview of the Subcommittee on Courts of the Senate Committee on the Judiciary. This Subcommittee has had bankruptcy legislation under its jurisdiction since the memory of man runneth not to the contrary. It is surely not responsible legislative process to attempt back door amendments or end run changes that if effect bypass those most conversant with the entire area. It is of major importance that the totality of bankruptcy legislation be considered when proposals are made to change the law in order to favor one group over another or one type of creditor over another. The Judiciary Committee and its appropriate Subcommittee are in the best position to (a) gather all of the relevant information, and (b) make an informed judgment.

For these reasons, this Committee should disapprove S. 1993 and S. 1992 but, if need be, at least refer them to the Committee of the Judiciary.

[The following information was subsequently received for the record:]

National Bankruptcy Conference,
New York, NY, March 25, 1986.

Hon. Daniel K. Inouye,
U.S. Senator, Committee on Commerce, Science and Transportation, Senate, Washington, DC.

Dear Senator Inouye: This in response to the written questions that were given to me by Mr. Hardy at the conclusion of my testimony on March 21, 1986 with respect to S. 1993 and S. 1992.

Question. Should the "partial immunity" or exception to the automatic stay provisions of the Bankruptcy Code contained in section 1110 of the Bankruptcy Code be expanded beyond ICC-regulated inland domestic vessels to include the class of vessels covered by Title XI guaranties as proposed by S. 1993 and S. 1992?

Answer. From its inception, section 1110 has been characterized as special interest legislation. It runs counter to the entire theme and underlying purposes of the reorganization provisions of the Federal bankruptcy law. Expansion of the coverage of section 1110 is antithetical to the express public policy that there be available to financially distressed entities a procedure and process which will enable them to effect reorganization and rehabilitation with concomitant preservation of going-concern values and jobs. The negative aspects of section 1110 should not be enlarged. Section 1110, to the extent applicable, requires the defaults must be cured and payments maintained in accordance with applicable documents if the debtor in possession or trustee is to retain the "vessel" or other property described in that section.

Chapter 11 reorganization cases usually occur because of the inability on the part of a financially distressed debtor to service outstanding debt. If the statute requires that debt service payments be met and the "vessel" or other property is necessary for the operation of the debtor's business, then the requirement to maintain debt service means that the reorganization case will be terminated. In that context, the enlargement of the coverage of section 1110 irretrievably narrows the possibility of effective reorganization of entities which would be affected by that statutory provision. As I have noted Congress originally elected not to include section 1110 in the bankruptcy reform legislation that was considered in 1978. It was only because of the very extensive lobbying efforts of equipment manufacturers and financiers that the limited provisions of former sections 116 (5) and (6) of the replaced Bankruptcy Act of 1898 were incorporated in the Bankruptcy Reform Act of 1978.

Any expansion of the coverage of section 1110 would have the effect of enlarging the number and type of financially distressed entities that cannot be rehabilitated under chapter 11. It would result in a greater number of liquidations with the attendant dismemberment and sale of assets and properties at liquidation values with accompanying economic losses to the communities in which those entities are located.

Question. Are chapter 11 cases used to avoid recapture of Investment Tax Credits and Accelerated Depreciation Tax Credits?

Answer. Contrary to the views of certain persons, chapter 11 is not deemed a desirable haven by American businesses. As a general proposition, resort to the protections of chapter 11 by business entities is a last resort. Chapter 11 cases are normally precipitated by financial difficulties and not tax problems, although a chapter 11 filing may affect tax credits and cause other tax consequences. A decision to file a chapter 11 petition is not one which is taken lightly by responsible business managements. The administration of chapter 11 cases is expensive and it carries with it (i) the potential displacement of management by a disinterested trustee, (ii) the potential of the conversion of the case to a liquidation case, (iii) the oversight of the court, (iv) the oversight of the United States Trustee, and (v) where applicable, the oversight of committees of creditors and shareholders. Thus, it would be atypical for a chapter 11 petition to be filed for the sole purpose of avoiding recapture of Investment Tax Credits or Accelerated Depreciation Tax Credits.

In addition the Bankruptcy Code contains protective provisions that enable the denial of confirmation of chapter 11 plans if the purpose of the plan is the avoidance of taxes. *See,* Section 1129(d) of the Bankruptcy Code. Indeed, the case law demonstrates that bankruptcy courts are sensitive to the potential of abuse in the perspective of the tax laws and, were appropriate, will deny confirmation of a plan of reorganization in such circumstances. *See, In re Maxim Industries, Inc.,* 22 B.R. 611 (Bankr. Ct. D. Mass. 1982).

In a similar vein, bankruptcy courts have demonstrated sensitivity to the potentiality of abuse of the bankruptcy process and have exercised the power to dismiss chapter 11 petitions as being filed in bad faith, where appropriate. *See, In re Albany Partners, Ltd.,* 749 F.2d 670, 674 (11th Cir. 1985); *In re Madison Hotel Associates,* 749 F.2d 410 (7th Cir. 1984); *In re Thirtieth Place,* 30 B. R. 503 (9th Cir. B.A.P. 1983).

Question. Are there not at least four exceptions to the automatic stay provisions (section 362) of the Bankruptcy Code for the benefit of the Federal Government?

Answer. The exceptions noted by you are correct. However, with the exception of section 362(b)(8) (the HUD exception), the other statutory sections listed in your letter, sections 1110(a) and 1168 (Railroad Reorganization) were incorporated into the Bankruptcy Code for the benefit of private lenders, after very extensive lobbying programs. Those sections do not represent any intent on the part of Congress to give the Federal Government any preferential or priority treatment for non-tax obligations. The thrust of my statement was with respect to the deletion by Congress of what has been a general priority for non-tax debts owed to the Federal Government. Under the former Bankruptcy Act of 1898, Section 64(a)(5) granted to the Federal Government a fifth priority claim status for such non-tax debts. As a consequence, in cases under that Act, non-tax claims of the Federal Government would be paid ahead of claims of non-government unsecured creditors. In connection with the bankruptcy reform legislation and the adoption of the Bankruptcy Code, Congress intentionally decided to delete and not carry forward any priority or preferential treatment for non-tax claims of the Federal Government and to put such claims on the same footing as general creditors in an insolvency case under the Bankruptcy Code. In effect, Congress has determined that when the Federal Government enters the credit markets as a lender or guarantor, it assumes the risks inherent in that activity and that any resulting claims should be treated on a parity with non-governmental commercial creditors.

The HUD exception is derived from former sections 262 and 517 of the repealed bankruptcy Act of 1898. In point of fact, it is more limited in application that in those earlier sections. Under the former Bankruptcy Act, the exception did not apply at all in arrangement proceedings under former Chapter XI. Section 263 was applicable only in Chapter X cases and Section 517 applied only in chapter XII cases. As I recall, the section 362(b)(8) exception was incorporated into the Bankruptcy Reform Act at the request of the Secretary of Health, Education and Welfare but, as I mentioned, in a much more restricted form. It only allows for the commencement but not the continuation of foreclosure actions of certain mortgages. It does not support the proposition that non-tax claims of the Federal Government should be entitled to special treatment with the consequence of effectively termination the reorganization and rehabilitation effort.

I hope that the foregoing satisfactorily responds to your questions. If you have any additional questions, I should be most happy to attempt to answer them.

Sincerely,

LAWRENCE P. KING,
Chairman, Committee on Legislation, National Bankruptcy Conference.

Senator STEVENS. Thank you very much for your time.

I understand that you do appear on behalf of the conference, is that right?

Mr. KING. Yes, I do.

Senator STEVENS. And they take a position against the bill?

Mr. KING. Yes.

Senator STEVENS. Both bills?

Mr. KING. Yes, both bills.

Senator STEVENS. Do you believe that there is sufficient protection in the Bankruptcy Code now for a secured creditor to be able to preserve the basic asset that is secured, notwithstanding the bankruptcy proceedings?

Mr. KING. Yes, I do.

As a matter of fact, depending on whom you talk to, there are people who will say there is too much protection for the secured creditors; that because of some court decisions, the balance which Congress tried to structure in 1978, which was a very fine balance, is kind of getting outweighed in favor of the secured creditor.

I will just mention how that comes about because of some court decisions.

Section 362 has been mentioned as the automatic stay. It also has been mentioned that under section 362, the secured creditor can come in and move for modification or relief from the stay, in which case the debtor—not the court and not anybody else—the debtor has the responsibility to come up with some means for adequately protecting that secured creditor against loss, loss caused by being refused permission to foreclose now.

The debtor has to come up with that means.

The court has to approve the means. The court has to say yes, what you are offering does adequately protect.

If the court finds it does not, then the court's only option is to grant relief to the secured creditor and permit foreclosure. The natural effect of that is going to be a liquidation in Chapter 11 or a conversion to Chapter 7 where the company will be liquidated, or a complete dismissal to let the proceeding take its course through foreclosure, outside the purview of a bankruptcy proceeding or the bankruptcy court itself. That is number one.

Number two, have expanded adequate protection and it is spreading among the circuits. The first to reach this was the Ninth Circuit Court of Appeals. The Fourth Circuit Court of Appeals has also agreed to it. The Eighth Circuit is a little bit wishy washy but, in a sense, has also agreed to this effect. The argument is made by the secured creditor, coming in with the same motion for relief from the stay: not only do I have to be protected against loss, let's say, if the collateral depreciates over the next year, years, or however long the debtor is going to use it, I need to be protected against that depreciation, that economic loss; but, also, if I am permitted to foreclose today, I will get *X* amount of money, whatever is the liquidation value of that collateral. I can take that money and reinvest it. I can make money on that money. I ought to be protected against that loss as well caused by the use of collateral in the proceedings, the cost of that loss.

The ninth circuit, the fourth circuit, and, in a sense, the eighth circuit have agreed with that argument.

Now, that, in itself, is a great protection for secured creditors, and, in some instances—and there have been some courts which have said this—if the debtor cannot afford to pay that lost opportunity cost, the debtor is not entitled to be in Chapter 11. The debtor should be liquidated.

Those are just two instances of such protection.

My statement goes into other instances of secured creditor protection.

Senator STEVENS. What are your comments concerning what appears to be the extraordinarily long period of time that apparently it takes the bankruptcy court to respond to the Government's request for relief?

Mr. KING. It should not take that long.

I have heard that testimony, and it really should not.

When I say "it should not," I mean because the way the Congress has fashioned the law, it had expedition in mind.

For example, section 362, again dealing with the automatic stay, has some subsections which provide for relief from the automatic stay. These subsections provide procedures for the secured creditor to obtain such relief. They contain deadlines for the court to act.

They do not contain one essential deadline, and the bankruptcy rules which became effective in 1983 fill that gap. Without going through all of the detail of that, the concept of both the statute and the rules was to provide an outside time limit of 90 days for the court to act, that is, 90 days either to continue the stay, based on the debtor offering what would be considered adequate protection against loss or to grant relief from the stay; but for the court itself to act within 90 days.

Now that is very unusual. You don't ordinarily see a statute giving the court a deadline within which to act.

The way the deadline works, if the court does not act, the secured creditor is entitled to relief from the stay.

Now, understand that courts may take longer to do that, but they are not supposed to. How you get courts to do things that they are supposed to do is another question.

Senator STEVENS. In other words, there is no sanction involved?

Mr. KING. No. There is no sanction on the judges. The secured creditor can come in, push, and shove, and take an appeal as well. There is the mandamus sanction in addition.

Senator STEVENS. I would invite you to look at my State statute. If they do not live up to the statutory deadlines, they cannot collect their pay the next month.

Mr. KING. I once suggested that to a Congressional committee for the bankruptcy judges, but it did not go very far.

Senator STEVENS. Alaska judges have a very high level of compliance with the statutory deadline.

You make the point in your statement that the proposed legislation would apply to the United States and all other U.S. vessel lenders to repossess vessels, equipment, and rigs, if the debt service payments are not resumed as contemplated by the proposed legislation.

Would you draw a distinction between the Government and other lenders with regard to assets of this type?

Mr. KING. No.

The reason that I made the point, basically, was that I understood the problem was a Governmental Maritime Administration problem, yet the legislation itself is so drafted that it covers all secured lenders. It's not limited simply to the Government. The National Bankruptcy Conference nevertheless would still be opposed to it if it were limited to the Federal Government.

First of all, to protect secured creditors to such an extent is going quite too far and would have a dire effect on the reorganization process. But even the Maritime Administration is probably the main creditor anyway, so it wouldn't make any difference, and should not be singled out for this favored treatment if the reorganization process is to mean anything.

If we are to do away with Chapter 11, then fine, we can go this route. We can have a system like England, where the secured creditor comes into court and appoints a receiver to take the collateral and to sell the collateral. They don't have reorganization. They sell, period. That is the end of it.

Well, we have a history of trying to rehabilitate companies in order to protect employees, in order to protect customers, in order to protect suppliers, and even in order to protect all of the levels of Government for taxes in the future, especially in the future.

Senator STEVENS. You also make this point: "Of course, the potential retroactive application of the proposed legislation can be disastrous to offshore drilling companies and shipping companies that may have been compelled to seek and are undergoing relief under Chapter 11 at this time. Those include Global Marine Inc. and its subsidiaries. Enactment of the proposed legislation undoubtedly will turn the pending cases into liquidation cases, with all of the concomitant drawbacks to such a process."

If the legislation were to be approved by Congress, I take it that your conference would recommend that it should be only prospectively applied. Is that correct?

Mr. KING. I should think that it should be prospective only, yes, and not retroactive, because companies have already made use of Chapter 11 based on their understanding of what that statute says and means.

Senator STEVENS. Wouldn't that cause a rush to the Bankruptcy Court between the time the bill came out of this committee and the time finally got to the President?

Mr. KING. I think one thing ought to be kept in mind. This comes up time and time again. It came up when Continental Airlines filed a Chapter 11 petition. It came up when Manville filed a Chapter 11 petition. A theory hit the newspapers that when you have some kind of problem, you are going to run to Chapter 11.

Chapter 11 is not regarded by corporate officers or directors as a panacea. It is a very, very risky operation, and that ought to be kept in mind.

Let me tell you of just two of the risks, very briefly.

One is there is a risk that management at any time during the proceeding is going to be ousted because any party in interest can come in and move for the appointment of a trustee. Granted, they may have to prove cause. On the other hand, another ground for moving for a trustee, a disinterested person is what the statute requires if a trustee is appointed, is when it is in the best interest of the estate.

So, management, which is filing the Chapter 11 on authority of the Board of Directors, may stand to lose their jobs. That is number one.

Number two, there is the risk of the company not making it, I don't care how good it is or how solvent it is prior to bankruptcy. There is a risk it won't make it and that it will be liquidated, either in Chapter 11 or Chapter 7.

I remember Manville saying in the newspapers when it filed its Chapter 11, "We're profitable, we can pay all our debts, this is not going to affect any of our regular payments."

Now, if you look in the newspapers, they are saying that the trade creditors are not going to get 100 cents on the dollar, they are not going to get postpetition interest. What happened between then and now? A great deal, and they took a great risk.

Corporate officers just will not use Chapter 11 willy nilly.

Senator STEVENS. Thank you very much, Professor King. Your statement and presentation demonstrate that you deserve the reputation that I have heard has preceded you. I appreciate your time and effort.

I want to ask Mr. Gaughan and Mr. Douglas to please provide the Government's comments on the statements made by Mr. King and Ms. Meadows and the supplemental statement that has been presented here on behalf of the bankruptcy conference.

I do appreciate your courtesy, too, Ms. Meadows. Thank you both very much.

[The following information was subsequently received for the record:]

Question. What are MarAd's comments on the statement of Ms. Sharon M. Meadows of the First Boston Corporation before the Senate Merchant Marine Subcommittee hearing on S. 1992 and S. 1993?

Answer. The First Boston Corporation statement focused mainly on the possible impact of the legislation on companies whose stock is publicly-traded. Therefore, most of the comments were not on point from the perspective of title XI.

Most title XI financed shipowners, who are now financially troubled, are privately held corporations and limited partnerships. These companies are not usually publicly held, nor are they regulated by the Securities and Exchange Commission ("SEC").

In the case of limited partnerships, for example, there are no title XI partnerships which fall within the definition of "publicly-traded companies".

The testimony focused on situations where the defaulting company, with numerous assets, would be inhibited from rehabilitation, if an asset were subject to quick foreclosure. The purported inhibition is that other institutional lenders would not want to invest in that business. In title XI transactions, lendors look to and rely upon the guarantee of the U. S. in determining whether to invest or not. Indeed, the offering circulars and the obli9ations themselves make clear that the investors have no interest in, nor any ri9ht to look to, the asset as collateral or security for their investment. This fact is properly noted by Mr. Vincent Cannaliato, Jr. a Senior Vice President at Smith Barney, Harris Upham & Co., Incorporated. He stated in his prepared comments on S.1992 and S.1993 that, "It is my opinion that the repossession issue has absolutely no effect on the private capital markets. Indeed, the title XI program is structured so that lenders have no reason to look through the United States government guarantee to the ultimate shipowner."

Without the proposed legislation, the U. S. government is the only loser in a "bankrupt" shipping transaction involving the title XI loan guarantee program. There is nothing in the legislative history of the 1978 Bankruptcy Code that infers that the Congress was committed to protecting debtors only. To the contrary, we find that the Congress felt that "speed and simplicity" to both creditors and debtors were goals in enacting the 1978 Bankruptcy Code. The Congressional Record below sets forth their goals:

"One cannot over emphasize the advantages of speed and simplicity to both creditors and debtors. From the perspective of creditors, early confirmation of a plan of arrangement: first, generally reduces administrative expenses which have priority over the claims of unsecured creditors: second, permits creditors to receive prompt distributions on their claims with respect to which interest does not accrue after the filling date: and third, increases the ultimate recovery on creditor claims by minimizing the adverse effect on the business which often accompanies efforts to operate an enterprise under the protection of the Bankruptcy Act." (124 Cong. Rec. S.17418, Oct. 6, 1978).

The Bankruptcy Courts are required to confirm onl? those plans of reorganization that meet the "fair and equitable" test and that are in the best interests of the creditor. However, submission of unreasonable plans of reorganization are repeatedly submitted to the Bankruptcy Court for confirmation, causing further delay in the disposition of the debtor's assets, including title XI financed vessels.

Secondly, there is nothing in the 1978 Bankruptcy Code nor the legislative history that one can use to infer that the Congress' objective was to enable defaulting companies to continue operating their business indefinitely without making debt service payments to their creditors, especially in situations in which such capital cost-free operations create a disturbance in the marketplace by allowing them to unfairly compete with viable companies.

An important concern to the Maritime Administration is that the defaulting shipowner may have no motivation, or worse, no resources to adequately maintain the vessel. A vessel, without proper maintenance, depreciates considerably during a relatively short period of time. Unlike real estate and other real property, a vessel depreciates in the normal course of time and if added to that depreciation is lack of maintenance, the value of the Maritime Administration's collateral becomes far less than the outstanding loan amount.

In conclusion, MarAd's opinion is that S.1992 and S.1993's impact on the public would be minimal—a position supported by the testimony of Mr. Vincent Cannaliato, Jr. of Smith Barney, Harris Upham & Co., Incorporated.

Question. Please comment on the Statement and Supplemental Statement of the National Bankruptcy Conference, which assert that S. 1993 is contrary to the basic concept of the Bankruptcy Code, would be counterproductive to the public interest particularly for the offshore drilling industry, does not recognize that in 1978 Congress deliberately eliminated protection of the United States as a secured creditor on a preferred ship mortgage from the automatic stay provision of the Code, and fails to take into account protections to the United States as a secured creditor under the existing Code.

Answer. The Maritime Administration believes that S. 1993 is entirely consistent with the 1978 Bankruptcy Code, would further the public interest and is essential to afford the secured ship mortgagees protection which they should have received under the Bankruptcy Code eight years ago.

The Code historically has provided certain creditors (including the Government) with a partial immunity from the automatic stay for high cost transportation equipment. S. 1993 would be consistent with the present exemptions accorded private and governmental purchase money secured creditors, lessors, and conditional vendors of railroad rolling stock, aircraft and aircraft equipment and vessels of ICC certificated water carriers under sections 1110 and 1168, none of which are discussed by the National Bankruptcy Conference. (On the other hand, the deletion of a special priority for payment of unsecured, non-tax debts owed the Government, discussed by the Conference, has nothing to do with congressional policies affecting the treatment of governmental and private secured creditors.)

Moreover, the legislative history clearly indicates that Congress intended MarAd to have the benefit of the section 1110 exemption. In this connection, we would point out that the quote from the Congressional Record used by the National Bankruptcy Conference before the Committee actually establishes the proposition that section 1110 was intended to extend to situations involving MarAd as a secured creditor. Thus Senator DeConcini and Congressman Edwards in discussing section 1110 said:

"Section 334 of the House amendment is identical with a provision contained in the House bill and Senate amendment. The bill codifies chapter XIV of the Bankruptcy Act, as amended by the Rules of Bankruptcy Procedure. Prior to adoption of the Rules of Bankruptcy Procedure, the Maritime Administration had a right to repossess vessels notwithstanding any contrary order of the court under section 703 of the Bankruptcy Act. * * * Reinstituting an absolute right for an agency of the Government to seize vessels is unwise and unnecessary. * * * Moreover, in a case under Chapter 11 of title XI, a secured creditor or lessor of a vessel is entitled to repossession after 60 days under section 1110 of title XI, unless the trustee or debtor in possession cures all prior defaults and gives adequate assurance of future performance. * * * ." 124 Cong. Rec. S17, 426 (daily ed. Oct. 6, 1978); H11, 10 9-11, 110 (daily ed. Sept. 28, 1979).

In restricting section 1110 to ICC certified water carriers, Congress was apparently unaware that the Government held only a very few preferred ship mortgages on ICC certificated water carriers and that it, therefore, would have almost no right to repossess vessels under section 1110. In practice, none of the many title XI defaults have involved an ICC certificated water carrier subject to section 1110.

To those who would argue that the intent of the above is not in fact clear, the need for section 1110 relief is amply demonstrated by virtue of the circumstances which have developed since 1978; viz. the failure of many single-asset, tax-oriented, minimally capitalized ship operators in both the domestic and foreign trades of the United States. In the last two years a significant number of shipowners have had access to the protection of Chapter 11 of the Bankruptcy Code with the result that they frequently operate in the market without operating capital requirements (except to the extent that a court may order adequate protection payments), and avoid substantial capital component payments. In addition, the defaulting shipowners may not be motivated to properly maintain the title XI financed vessels which are the primary, and, in most cases, the sole collateral available to MarAd. At the same time, these owners, in some instances, have enjoyed substantial tax benefits available to them under the Internal Revenue Code for their original investments.

Unfortunately, experience shows that the Bankruptcy Code does not protect a secured creditor, such as MarAd, against these abuses, and the National Bankruptcy Conference did not address our unique problems. Without enactment of S. 1993, which poses no threat to the underlying precepts of the Bankruptcy Code, the public interest will continue to be subordinated to the private and special concerns of those who are now under no real time pressure to reorganize and make provision for timely repayment of any portion of their indebtedness.

S. 1993 would advance the public interest by protecting the shipping industry, as a whole, from the unfair competitive advantage of defaulting shipowners who, absent adequate protection payments, have little capital component costs to defray their in operations. Furthermore, the public interest would be enhanced by virtue of the enactment of this bill because it would, in effect, accelerate the commencement of either a repayment of the debt, the presentation of a debtor's plan for repayment or, as a last resort, the acquisition of the collateral.

It is important to note that under the proposed section 1110 amendment, MarAd would not have the immediate right to take vessels upon a default, but only after a period of at least 60 days after the date of the order for relief. As a practical matter, these negotiations would have been ongoing before a shipowner default, Government payoff and any bankruptcy filing. Typically there would be six months of negotiations. Further, section 1110 allows the secured party, with court approval, to extend the 60-day period.

Therefore, MarAd, in reality, would not be in a position to push companies into liquidation precipitously, and it certainly would not utilize the partial exemption to recover and foreclose where there are reasonable prospects of repayment and reorganization. In this regard, it should be remembered that the 1936 Merchant Marine Act established as one of its goals the promotion of a privately-owned U.S. merchant marine. Consequently, in carrying out this congrssional mandate, MarAd must act responsibly in its dealing with all U.S. shipping interests and see to it that individual special groups or individuals are not inadvertently and unfairly favored over all other industry segments.

The National Bankruptcy Conference raises the issue of what MarAd will do with the vessels once it obtains title. As has been indicated above, MarAd is required by statute to promote the merchant marine. One area of tis promotional obligation is the disposition and utilization of the U.S.-flag fleet. Consequently, MarAd will make decisions with respect to the use and disp[osition of those vessels to which it acquires title considstent with this mandate.

The above issue, however, cannot be used to mask the present intolerable situation. Today, the Government cannot sell at any price, lay up or stack, nor attempt to employ the vessels, simply because it does not have any options, other than the circuitous al process available in the Bankruptcy and Admiralty Courts. The debtor shiwner, on the other hand, has a number of options—all favorable. The debtor continue to operate the equipment, largely free from debt, until reorganization or liquidation (not uncommonly, a lengthy process) at a rate that those, who are paying their title XI debt service, are unable to meet. If the debtor chooses not to operate, absent a motion for adequate protection payments, there is no compulsion to maintain the collateral in a reasonably business-like manner. The debtor also has the opportunity to remove the vessels from the reach of U.S. courts.

The 1978 amendments could not be construed to internally sanction such disparate treatment.

In sumary, S. 1993, in our view, is merely correcting the Congressional oversight of 1978; is consistent with the exemption granted to other secured creditors in the transportation industry; is not detrimental to the promotional aspect of the 1936 Act; furthers the public interest in that it permits an early determination and disposition of the defaulted debt and acquisition of tcollateral; and is in keeping with the tenor and rationale of the Bankruptcy Code.

Senator STEVENS. Our next witnesses are Mr. Donnelly and Mr. Pyne.

Mr. Donnelly is vice chairman of Ingram Barge Company and Mr. Pyne is president of Dixie Carriers, Inc.

Mr. Donnelly, would you go first. Would you begin, if that is agreeable.

STATEMENTS OF JOHN M. DONNELLY, JR., VICE CHAIRMAN, INGRAM BARGE CO.; AND J. H. PYNE, PRESIDENT, DIXIE CARRIERS, INC.

Mr. DONNELLY. Thank you, Mr. Chairman.

My name is John M. Donnelly. I am vice chairman of Ingram Barge Company of Nashville, TN.

The difficult situation confronting our industry has been well documented and publicized. The inevitable result has been a series of bankruptcies among the large and small carriers alike. I am referring basically to the inland waterway industry.

Many of these carriers have equipment financed under the title XI Guarantee Program. Despite the fact that MarAd is legally obligated to immediately pay off bond or note holders in the event of a default, MarAd itself cannot begin to recover its losses until lengthy bankruptcy proceedings are completed.

In the meantime, the bankrupt companies can recklessly continue to operate the vessels in default with little or no costs to cover, causing significant harm to those companies such as ours which continue to meet their obligations.

The key question posed by this legislation is whether MarAd should be treated differently from other creditors in a bankruptcy proceeding.

We strongly believe that the answer is affirmative because of MarAd's creditor role and that it is different from other creditors. MarAd has an obligation to protect the public interest, especially as it concerns MarAd's total obligations under title XI.

MarAd's role is that of a guarantor; their direct role as a creditor in a bankruptcy proceeding often follows and does not precede the act of bankruptcy itself. Thus, MarAd is denied many of the rights and opportunities otherwise available to creditors prior to the event of bankruptcy itself.

Without legislative changes, additional companies may choose the bankruptcy option in part because guarantees by MarAd give companies and creditors alike little incentive to press for other solutions. The result will be numerous companies in our industry operating under the protection of the bankruptcy laws with assets against which they have no current capital obligations. Companies that are more efficient and can meet their obligations, including those guaranteed by MarAd, may well be threatened by bankrupt competitors who have been, in effect, subsidized by MarAd.

On the other hand, if this legislation is enacted, MarAd has the opportunity to prudently and judiciously deal with companies for whom bankruptcy is a fact or a possibility. This could serve as a stabilizing influence on our industry, protecting the viability of existing carriers and also protecting the integrity of MarAd's remaining title XI obligations.

Mr. Chairman, that is a summary of my prepared remarks.

But in listening to some of the other panelists, a couple of thoughts did occur to me and I would like to state those.

In the inland barge and towing industry, we are suffering with a tremendous overpopulation of equipment and I do submit that the problems of the industry are such that a debtor in title XI bankruptcy today cannot be rehabilitated. The rate structure in the industry is such that they cannot be made viable, and it is strictly an artificial life that is being breathed into the debtor, and at the conclusion of Chapter 11, you do not have a rehabilitated company, but you have the final remains of the company.

In the meantime, the once healthy companies have suffered because of the further rate degradation that has continued while the debtor has been sustained artificially.

[The statement follows:]

STATEMENT OF JOHN M. DONNELLY

Mr. Chairman and members of the subcommittee; my name is John M. Donnelly; I am Vice Chairman of Ingram Barge Company, an inland marine operator headquartered in Nashville, Tennessee. My company and our entire industry is vitually interested in this bill and I appreciate the opportunity to testify before you today on S. 1992 and S. 1993.

I have personally been involved with the inland marine industry since 1955. I am a Director of the American Waterway Operators (AWO), the national trade association which represents the domestic inland and coastal waterways industry, and was Chairman of the Board of this organization in 1980. While my views reflect only the position of Ingram Barge Company, many segments of our industry support this legislation.

Ingram Barge Company is one of the largest inland marine companies in this country. We operate nearly a thousand barges and three dozen towboats on the Mississippi River, its tributaries and along the Gulf Intercoastal Wateway. Ingram has been a beneficiary of the MARAD Title XI Guarantee program. A number of our boats and barges were purchased and financed under provisions of the Title XI program and Ingram has met, and expects to continue to meet, its financial obligations on this equipment.

MOTIVATION FOR THIS LEGISLATION

The difficult situation confronting our industry has been well documented and publicized. During the late seventies, concensus projections concerning future increases in grain and coal exports led our industry, including Ingram, to expand the size of the hopper and towboat fleet. Unfortunately, by 1982 this fleet expansion was met, not by an increase in exports, but by a dramatic decline as government policies and other external factors led to real reductions in the demand for barge freight services.

The inevitable result has been a series of bankruptcies among large and small carriers alike. Many of these carriers were those involved in the expansion during the late seventies, with equipment financed under the Title XI guarantee program.

Today, the Secretary of Transportation is prohibited from taking unilateral foreclosure action on a Title XI equipment mortgage which is part of a bankruptcy proceeding. Despite the fact that MARAD is legally obligated to immediately pay off bond or note holders, MARAD itself cannot begin to recover its losses until lengthy bankruptcy proceedings are completed. In the meantime, the bankrupt companies can recklessly continue to operate the vessels in default with little or no costs to cover, causing significant harm to those companies such as ours who continue to meet their obligations.

ECONOMIC RATIONALE FOR THE CHANGE PROPOSED IN S. 1992 AND S. 1993

It is our understanding that prior to the Bankruptcy Reform Act of 1978, when a vessel owner defaulted on a Title XI loan as part of a bankruptcy proceeding, the bankruptcy court did not have the statutory authority to enjoin the Secretary from foreclosing on the vessel mortgage. Apparently in enacting the 1978 reforms, Congress unintentionally eliminated the Secretary's immunity from the automatic stay provisions. This legislation simply corrects this oversight and re-establishes the provisions as intended prior to the 1978 legislation.

The above notwithstanding, however, the key question posed by this legislation is whether MARAD should be treated differently from other creditors in the context of a bankruptcy which effects equipment financed under the Title XI guarantee program. We strongly believe that the answer is affirmative because:

MARAD's creditor role is different from other creditors.

MARAD has an obligation to protect the public interest as concerns MARAD's total obligations under Title XI.

MARAD has an obligation, as is their charter, to promote the health of the maritime industries in this country.

It is absolutely crucial to recognize that MARAD's role is that of a guarantor; their direct role as a creditor in a bankruptcy proceeding often follows and does not precede the act of bankruptcy itself since, in many cases bankruptcy and default on the MARAD guaranteed loans occur at the same point in time. MARAD may not even enter into the deliberations until a default or bankruptcy has occurred and is therefore denied many of the rights and opportunities otherwise available to creditors prior to the event of bankruptcy itself.

Worse still, MARAD's role as a guarantor has a pernicious affect on companies facing possible bankruptcy and on those creditors who are guaranteed payment on the assets. Without the ability to foreclosure on Title XI boats and barges which are part of a bankruptcy proceeding, MARAD is in an impossible situation—unable to exert any influence prior to the bankruptcy filing, and then unable to take action with respect to its guaranteed assets, even though MARAD itself must immediately meet its obligation to bondholders or noteholders.

MARAD'S POTENTIAL ROLE AND THE CONSEQUENT IMPACT ON THE INLAND INDUSTRY

If the bankruptcies in our industry were isolated occurrences, or if the health of our entire industry were not at risk, the issues addressed in this legislation would be mere technical matters of little interest to companies such as Ingram. Unfortunately, the financial situation of our industry has shown little sign of improvement since 1982. Thus, MARAD's role as a guarantor on a significant percentage of the barges in our fleet places them in a position of having a substantial role in the future health and viability of our industry.

Without legislative changes, additional companies may choose the bankruptcy option in part because guarantees by MARAD give companies and creditors alike little incentive to press for other solutions. The result will be numerous companies in our industry operating under the protection of the bankruptcy laws with assets against which they have no current capital obligations. Companies that are more efficient and can thus meet their obligations, including those guaranteed by MARAD, may well be threatened by bankrupt competitors who have been in effect subsidized by MARAD.

On the other hand, if this legislation is enacted, MARAD has the opportunity to prudently and judiciously deal with companies for whom bankruptcy is a fact or a possibility. This could serve as a stabilizing influence on our industry, protecting the viability of existing carriers and also protecting the integrity of MARAD's remaining Title XI obligations. We urge this Committee to support this very important legislation.

Thank you for the opportunity to appear before you. I would be pleased to answer any questions you or your colleagues may have.

Senator STEVENS. Instead of giving the Government special privileges in bankruptcy, why shouldn't we instead constrain the bankruptcy courts from allowing assets to be managed in a predatory fashion which you and the Government witnesses describe? What you are really saying is because they are free of capital costs, these assets can go out and cause even greater havoc in the industry. Is that right?

Mr. DONNELLY. Well, I think that is part of the problem. I think that before that fact is determinable by the court, there would be a sufficient time delay so that you would have some of the same bad effects regardless.

Further, if I might make one other observation in listening to the other panelists, I would say if the Maritime Administration had the power to repossess equipment, whether or not they ended up repossessing the equipment, I think they would have a much better bargaining chip in dealing with the debtor, and I believe they could cause the debtor to behave more responsibly. I think they probably could make for much better agreements with him prior to the introduction of any bankruptcy proceeding.

Senator STEVENS. You make a good point about the Government's position as a guarantor. I appreciate your statement.

Mr. DONNELLY. Thank you.

Senator STEVENS. Mr. Pyne.

Mr. PYNE. Thank you, Mr. Chairman.

I am Joe Pyne, president of Dixie Carriers, Incorporated, a tug and barge company headquartered in Houston, TX.

I appreciate the opportunity to appear before you today.

I support the enactment of S. 1992 and S. 1993.

In my view, it is essential that the Department of Transportation have immunity from the automatic stay provisions of the Bankruptcy code.

I understand that prior to the 1978 reform of the Bankruptcy Act, the Department of Transportation had this authority.

Additionally, this authority is not unprecedented. I understand that HUD, the FAA, and the Federal Railway Administration have immunity from the automatic stay provision.

Mr. Chairman, our industry is in the midst of a terrible depression, caused primarily by a significant overcapacity of barging equipment.

Much of this equipment was a result of speculative building and much of it was financed by loans guaranteed under title XI. It is ironic today that much of the same equipment built in expectation of large profits and ultimately caused the tremendous losses that we have incurred.

Giving the Secretary immunity from the automatic stay provision is very important. There is, however, a much broader question which I believe must be addressed by the Department of Transportation, which is the overall policy concerning defaults.

Current law authorizes the Secretary to institute foreclosure proceedings in a timely manner when a ship owner in default has not filed for Chapter 11 reorganization. As far as I am aware, the Maritime Administration has not foreclosed in a timely manner, but instead has entered into specialized work-out agreements. Although I do not know specifically why the Maritime Administration has chosen to enter into these agreements, I speculate that it is because if they did not enter into such an agreement, a company which has defaulted would file for bankruptcy and be protected until the company reorganized or was liquidated.

It could be argued, in fact, it has been argued, that it is better to forgive debt or advance interest and principal payments to avoid default than to force a company into bankruptcy because once in bankruptcy, the company is able to operate for a period of time without servicing any debt.

This is a powerful argument.

However, I ask you is it fair or is it healthy to an industry as vital as this nation's maritime industry, already plagued by over-capacity, to continue to subsidize companies which have nonperforming loans at the expense of companies who meet their obligations?

Some will argue that the Maritime Administration should have the same rights that banks have to work out restructuring plans to accommodate companies in default. They will also argue that the Maritime Administration should not be exempted from bankruptcy law, but should be required to stand in line with all the other creditors.

I disagree with these arguments.

The Maritime Administration's purpose is to protect and to encourage this nation's maritime interests. To continue to subsidize non-performing loans will only serve to drag our industry further into depression and is contrary to the Maritime Administration's purpose.

Before I close, I do not want to leave the impression that the Maritime Administration or the title XI program were the sole causes of our industry's economic woes. Nor do I want to imply that by accelerating foreclosures we will have a total cure.

I do believe that enactment of S. 1992 and S. 1993 will have a positive effect on the barge and towing industry because it will cause us all to compete on the same basis.

We will all have to meet our obligations.

However, I do want to add that if the Department of Transportation is given the right to foreclose, I believe it is just as important to exercise that right.

Mr. Chairman, thank you for the opportunity to appear before you.

I will be happyto answer any questions.

[The statement follows:]

STATEMENT OF J.H. PYNE, PRESIDENT, DIXIE CARRIERS, INC.

Mr. Chairman and members of the subcommittee, I am Joe Pyne, president of Dixie Carriers, Inc., a tug and barge company headquartered in Houston, TX. I appreciate the opportunity to testify before you today on S. 1992 and S. 1993, Bankruptcy Code Amendments.

Dixie Carriers operates liquid barges and towboats on the Mississippi River and its tributaries, the Gulf Intracoastal Waterway, and we operate liquid and dry cargo barges and tugs in the waters of the Gulf of Mexico, the east and west coast of the United States, the Caribbean, and to and from countries in South and Central America and Africa.

I personally have been involved in the barge and towing business for eight years, and am a director of the American Waterways Operators [AWO], the national trade association representing the domestic inland and coastal waterways industry, and small- to medium-sized shipyards and ship repair facilities. While AWO has not yet taken a formal position on S. 1993 (applicable specifically to our industry), the legislation has broad support.

Some background information is important to frame this issue. The industry I represent is today much different from the industry of the late 1970's. At that time, over 1,800 companies were operating towing equipment on the waterway system, most of them thriving enterprises: Today there are far less and few are doing well. In 1981, our industry began a dramatic and tragic decline caused by a number of factors: The most important factor, in my opinion, being the enormous overcapacity of barging equipment in our business, and since that time the industry has been in the midst of a severe and crippling economic depression.

According to an Arthur Andersen study concerning the financial performance of 15 leading inland companies between 1980 and 1983, these companies experienced a combined revenue decline in excess of 10 percent and combined before tax profits fell from a positive $120 million in 1980 to an aggregate loss of nearly $30 million in 1982. 1983 losses were in excess of $40 million.

While we have no similar statistical documentation, subsequent years brought even greater losses for these once profitable companies. For example, of these 15 companies, only nine survive today as viable enterprises.

Please keep in mind, Mr. Chairman, that these were some of the larger barging companies. The mid-sized and smaller companies, lacking financial staying power, have gone under in cascading numbers. For example, a credit assurance company in the Midwest reported over 70 marine related business failures in a three-year period in just a single region. It is estimated in 1984–1985, another 20 percent of the industry closed their doors or filed for chapter 11 bankruptcy.

The key question in front of this committee today is what happens to the equipment operated by companies no longer economically healthy? The legislation under consideration by you today can change the answer to this question in a way which will help this devastated industry and will save a few operators who despite these terrible times are struggling to meet all their obligations, under conditions which include staff cuts, salary and benefit reductions, and the postponement of capital expenditures.

The title XI Federal ship financing program, as amended in 1972, was transformed from a mortgage insurance format into a full faith and credit government loan guarantee. Over the years, the Maritime Administration has granted billions of dollars in vessel construction loans, much of it to the once very profitable barge and towing industry. Since 1970, approximately 27 percent of all inland hopper barges and 30 percent of all tank barges were financed by title XI funding. Now, due to the severe industry depression, an increasing number of operators are struggling to meet their Marad loan payments or are unable to meet these payments: More and more defaults are occurring. Additionally, a number of operators are filing for reorganization under chapter 11 of the Federal Bankruptcy Code. Both situations have created a crisis for the Maritime Administration and for our industry. Unfortunately, I believe the Maritime Administration will have a greater percentage of default on the equipment they financed because until recently their loan standards were generally lower than other lending institutions.

By enacting S. 1992 and S. 1993, Congress can provide the Secretary of Transportation with the right to seize equipment in default in order to remove it from a market already saturated with equipment without going through lengthy court proceedings to lift the automatic stay, ofter a minimum of two years.

Giving the Secretary immunity from the automatic stay provision is very important. There is, however, a much broader question which must be addressed by the Department of Transportation . . . what is its overall policy on defaults? Current law authorizes the Secretary to institute foreclosure proceedings in a timely manner where a ship owner in default has not filed for chapter II reorganization. As far as I am aware, the Maritime Administration has not foreclosed in a timely manner but has instead entered into special, individualized "workout" agreements. Although I do not know specifically why the Maritime Administration has chosen to enter into these special agreements, I speculate that it is because if they did not enter into such an agreement, the company which has defaulted would file for bankruptcy and be protected until the company reorganized or was liquidated. It could be argued that it is better to forgive debt or advance interest and principal payment to avoid default, than to force the company into bankruptcy because once in bankruptcy the company is able to operate for a period of time without servicing any debt.

This is a powerful argument. However, I ask this committee—is it fair or healthy to an industry as vital as this Nation's maritime industry, already plagued by overcapacity, to continue to subsidize companies which have nonperforming loans at the expense of the companies who meet their obligations? Some will argue that the Maritime Administration should have the same rights that banks have to work out restructuring plans to accommodate companies in default. They will also argue that the Maritime Administration should not be exempt from bankruptcy laws but should be required to stand in line with all the other creditors.

I disagree with these arguments. The Maritime Administration's purpose is to protect and encourage this Nation's maritime interest. They do so with public, not private, money. To continue to subsidize nonperforming loans will only serve to drag our industry deeper into depression, contradictory to the Maritime Administration's purpose.

Mr. Chairman, it is somewhat awkward and uncomfortable to appear before you opposing the special workout agreements which have assisted some of my colleagues. However, I submit these special workout agreements are not the answer and they have proved to have a devastating ripple effect on the rest of the industry.

In both instances, the vessels in default are being operated with little or no costs for the operator to cover, causing significant economic injury to those carriers, such as my company, who are able to continue to honor their debt obligations. We are a large company in a much stronger position than many others. Even so, we should not be forced to compete at a serious disadvantage with those operators benefiting from these Marad special agreements and therefore able to substantially underbid us. This only serves to make a bad situation worse by forcing companies still alive and meeting their obligations into poorer health. It is as if the dying pull the survivors into the grave with them. No one can support that.

That is why my company, along with a broad reach of our industry, support this legislation. However, unless the Maritime Administration considers foreclosure as the option instead of one option at its disposal, the bill serves no purpose. I should add that this position is not held unanimously in the industry. Those operators on the brink of bankruptcy would, no doubt, disgree.

I do not want to leave the impression that the Maritime Administration and the title XI program were the sole causes of our industry's economic woes. Nor will accelerated foreclosures be a total cure. In my view, enactment of S. 1992 and S.1993 will have a positive effect on the barge and towing industry because it will cause us all to compete on the same basis. We would all have to meet our obligations.

Mr. Chairman, thank you for the opportunity to appear before you. I'm happy to answer any questions you and your colleagues may have.

Senator STEVENS. I think you make a very good point and we will look at it.

It would seem, however, that should there be only one option—and that is foreclosure—in a period of time such as we are in right now, it would permit new operators to enter your market with little or no capital investment. We would in effect be starting another cycle that would further destroy the industry itself.

Isn't that right?

Mr. PYNE. I think that is a risk. It depends on what the Maritime Administration does with the equipment. If the equipment is sold at an auction or through offerings, there is a chance that new investors will enter the market and buy equipment at reduced prices.

I also believe that many of the healthy operators will also buy that equipment, and essentially what we will have is a consolidation of the business, which I believe will be healthy.

Senator STEVENS. Very well.

I will ask that MarAd comment on that additional option that you have raised, and I do appreciate your taking the time to present your testimony.

Thank you both very much.

Our next witnesses are Mr. Mills, Mr. Waldorf and Mr. Newcomb.

Mr. Mills, you are the first on my list.

STATEMENTS OF THOMAS L. MILLS, COUNSEL, ON BEHALF OF APEX MARINE CORPORATION AND CROWLEY MARITIME CORPORATION; ACCOMPANIED BY LEONARD EGAN, COUNSEL; KENNETH W. WALDORF, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, ZAPATA GULF MARINE CORPORATION; AND JOHN C. NEWCOMB, VICE PRESIDENT, SONAT MARINE, INC

Mr. MILLS. Good morning, Mr. Chairman.

I have with me at the table my partner, Leonard Egan.

I am here for Apex Marine and Crowley Maritime in support of your bills, although we have submitted and suggested a slightly different format.

In the view of Crowley and Apex, the purpose of the bills can be achieved most simply and with the least effect on the general law of bankruptcy by a single bill amending section 362 of the Bankruptcy Code. We have attached our draft with my prepared statement.

Your bills, S. 1992 and S. 1993, amend section 1110 of title XI. Section 1110 is designed to protect private parties with security interests in certain aviation and marine transportation equipment.

There may be objections to S. 1992 and S. 1993 in that they would cover ship mortgages in favor of private parties and security interests arising under state laws for vessels under construction.

There are legitimate concerns raised where certain private lenders are accorded preferential treatment over other private lenders based solely on the type of equipment for which the loan is made. Although some express similar concerns when the lender is a Government agency, we believe there are valid reasons for granting preference to a Government lender, acting in furtherance of a Government-directed promotional program, that are never present in the case of a private lender.

Prior to the revision of the Bankruptcy Code in 1978, foreclosures on mortgages held by MarAd under title XI and by the Department of Housing and Urban Development under the National Housing Act were exempt from the automatic stay.

The 1978 code retained an exemption for HUD by incorporating it into section 362(b), but the exemption covered only the commencement and not the continuation of foreclosure. No provision was made for MarAd's mortgages at all.

Although the present HUD provision would not be adequate to cover MarAd's problems, we think 362(b) is the appropriate place to provide an exemption for a Government program since other exemptions for Government agencies or actions are included therein.

Our proposal is quite simple. It substantially takes its text from the version of the HUD exemption, from the original Senate version of the 1978 revision, which covered both commencement and continuation of foreclosure. It would make commencement and continuation of foreclosure of mortgages held by MarAd or NOAA under the Merchant Marine Act exempt from the automatic stay that goes into effect upon the filing of bankruptcy.

The amendments would not apply to mortgages on vessels whose owners have already filed for bankruptcy. Only filings made after the effective date would be subject to its provisions.

Thus, no stay already in place would be affected.

Although neither I nor my clients have really detailed knowledge of the HUD program, we understand that they have been able to work within the confines of their existing law because it is very unusual for a defaulting debtor to actively seek to reorganize.

Accordingly, it is not difficult to have the stay removed. Unfortunately, presently the opposite is the case with respect to MarAd. Since 1978, it has been confronted with an ever-increasing number of defaults and a substantial number of them have resulted in filings under Chapter 11, where the automatic stay causes the most delay.

The reasons for this exemption are compelling. Mr. Gaughan and some of the private witnesses have outlined them. I would like to emphasize the problems from the commercial operator's side.

In most cases, the defaulters are single ship companies or companies that own no real assets other than ships. They have no real chance of emerging from bankruptcy since their markets have generally continued to deteriorate after filing.

Mr. Chairman, we heard earlier from the First Boston witness and the National Bankruptcy Conference witness good reasons compelling reasons, for not treating Government lenders, Government agencies, differently. But I think that their testimony had little to do with the realities of the shipping business. The shipping business, as you know, Mr. Chairman, is very different from other businesses.

Companies which make widgets might well be able to reorganize and make gadgets, but companies who operate ships, operate ships. When MarAd is involved, MarAd has guaranteed 75 to 87.5 percent of the capital cost of the ship. So, when the market goes, it does not take a genius to know whether or not reorganization makes any sense at all, and in the very large proportion of the cases, reorganization has no relevancy whatever to maritime commercial defaults.

Accordingly, the reasons for not wanting to treat MarAd differently then other lenders I think are inappropriate in the maritime context.

Title XI is, of course, a promotional program, intended to provide advantageous financing terms to the U.S.-flag shipping industry. When the bankruptcy law works to provide a benefit to operators who default on title XI to the detriment of those who continue to make scheduled payments, it erodes the very purpose of title XI.

In the view of Crowley and Apex, the amendments to the Bankruptcy Code are necessary to avoid a clear conflict between existing bankruptcy law and the promotional purposes of title XI.

I think your point, Mr. Chairman, which you made earlier, especially with respect to the offshore industry, the drilling rig industry, about whether the industry would be any better off if MarAd moved to foreclose immediately and then just resold the assets at a fire sale price, thus putting the asset with virtually no capital cost out on the market, is an excellent one. I think the purpose for which the exemption from the automatic stay would be granted, depending very heavily on MarAd's promotional purpose, carries with it the responsibility that MarAd act responsibly with those assets. Perhaps that ought to be clearly stated in any bill which moves forward.

That concludes my prepared statement.

I would be glad to answer any questions.

Senator STEVENS. Thank you. I read your complete statement.

I think the bill you suggest is an interesting one. I will introduce that by request and ask for a comment from the people who are involved in this issue on its potential impact.

Mr. MILLS. Mr. Chairman, I would make one additional point.

Our bill differs in one point in that it does not have the automatic 60 days in there. Some of the earlier witnesses talked about the possibility of precipitous MarAd action. I think it is important to get on the record just what kind of time is involved, other than what we heard about the time during which the automatic stay is involved.

Title XI payments are made on a semi-annual basis, so you start out with at least 6 months of period during which a debtor, a MarAd debtor, is operating and knows or has reason to believe that it is in some kind of trouble.

If it does not make its payment, there is then a 30 day period of grace. After the 30 day period of grace, there is a 60 day period within which the trustee, the indenture trustee (that is, the representative of the bondholders), can move for MarAd to pay off the loan, and then MarAd has an additional 30 days after that to pay off.

So, when you add then the automatic stay, which is now extant, upon the end of that, you are talking about a very substantial period of time during which a debtor in possession can be operating in the market without making any capital debt service.

Further, quite aside from the structural delays built in title XI, I think the notion that MarAd would act precipitously is kind of nonsense. MarAd is a Government agency, number one, and I think while it may be accused of a lot of things, acting precipitously is not one of them.

I say that, I guess, with some affection.

At the same time, I think that the notion that people would run off to the Bankruptcy Court is also not an accurate one. It is kind of the last step and there is no place to go after bankruptcy. So I really do not think that is a problem.

Senator STEVENS. Thank you very much.

Mr. Waldorf.

Mr. WALDORF. Thank you, Mr. Chairman.

I appreciate the opportunity to be here this morning to testify in favor of the passage of S. 1993, a bill to reform the Maritime Administration's title XI loan guarantee program.

I am chairman and chief executive officer of Zapata Gulf Marine Corporation. We operate a fleet of 423 marine service vessels, 125 of which are in the Gulf of Mexico.

While we perform towing and other services, our principal job is to support offshore oil and gas operations.

I am appearing this morning on behalf of other offshore oil companies as well as Zapata Gulf. They are listed in the attachment to my written testimony.

Before I assumed my current position, I was president of Zapata Off-Shore Company. Consequently, I am familiar with drilling rigs as well and can address the title XI question from the perspective of both a boat and a rig operator.

Under the title XI program, MarAd guarantees loans to finance the construction of U.S.-flag vessels, including service boats and driling rigs.

The current recession in the offshore industry, made even worse by falling prices of oil, is causing a number of companies to default on their title XI guaranteed debt.

Some of these, however, are continuing to operate their vessels under the rotection of Chapter 11 of the Bankruptcy Code. Further, I believe we will see many more reorganization attempts under the provisions of Chapter 11, as the offshore depression deepens during 1986.

This creates two problems. The first is that MarAd has totally exhausted its title XI Loan Guarantee Fund and this means general fund revenues are being used to pay off defaulted title XI loans.

On September 30, 1985, a report by the Maritime Administration indicated that defaults for all classes of vessels totaled more than $560 million, a figure that has increased, as you head this morning.

While I do not have exact figures on what percentage is made up of offshore equipment, I can safely say that it is now in excess of $200 million.

There is a second problem. At the same time the taxpayers are being asked to pay off the debt of failed companies, some of those very companies that are continuing to operate under the protection of Chapter 11 are undercutting the market because they do not have to service any debt.

In one case, an oilfield service company filed for Chapter 11 protection and defaulted on their MarAd loans, then continued to operate with the apparent sole purpose of allowing the partnership owners to avoid recapture of investment tax credits and accelerated depreciation tax credits that they had received through the venture.

In other words, it was a taxpayer sponsored subsidy of unprofessional operators.

In another case, a service vessel company is openly preparing to operate in violation of MarAd regulations. This firm is in default on its title XI loans, yet it is now working for a foreign state oil company without MarAd approval.

Under current law, because of the threat of Chapter 11 protection, MarAd is virtually powerless to stop them.

This means U.S. taxpayers are essentially subsidizing foreign oil operations.

This abuse of title XI is patently unfair to companies like Zapata Gulf and most of the other members of the offshore industry who are continuing to meet their title XI obligations, while struggling to stay afloat in very difficult economic times.

On many occasions, we have lost contracts because we were underbid by competitors abusing Chapter 11 bankruptcy protection.

I do not believe that Congress intended to make taxpayers subsidize failed boat and rig companies when they amended the Bankruptcy Code in 1978. Up until that point, MarAd had the authority to foreclose on and seize vessels in default and sell them to recover at least some of the funds expended under title XI.

S. 1993 would reestablish that authority. This approach is supported by both the Secretary of Transportation and the Maritime Administration, as well as the leaders of both parties in the House.

Passage of S. 1993 would be a direct benefit to the taxpayers, especially in the light of Federal spending. Further, I believe passage of the bill is supported by a significant majority of this nation's rig and boat operators.

Thank you, Mr. Chairman.

Senator STEVENS. Thank you very much, Mr. Waldorf.

I am going to introduce Mr. Mills' proposal, and I would appreciate anyone who is interested in the subject to comment on that so that we can give an alternative to the committee to consider as we proceed with this legislation.

Before we go to Mr. Newcomb, I want to announce that we will put into the record the prepared testimony of Vincent Canaliat, who is submitting that on behalf of Smith, Barney, Harris, Upham and Company. It will be printed in the record.

Mr. Newcomb.

Mr. NEWCOMB. Thank you very much.

My name is John Newcomb. I am a vice president of Sonat Marine Inc.

We are the largest independent U.S. flag transporter of petroleum, carrying about 225 million barrels of petroleum each year, primarily along the U.S. East and Gulf Coast. We are in what is called the Coastwise trade.

We participate in the title XI ship financing program administered by the Maritime Administration. So, our comments, in a sense, are directed toward ourselves in that we could wind up, theoretically, in a situation that this proposed legislation speaks to.

Nevertheless, we strongly support S. 1993, particularly recognizing the unique role of MarAd. MarAd is a guarantor; there is a U.S. Government guarantee of bonds that are sold. This results in lower interest rates to the borrower.

It is a different situation than a private lender taking collateral in the equipment itself, because that results in the borrower borrowing at the prime rate or whatever the going rate is for that company.

Here you have a situation where, for promotional purposes, the Government guarantees principal and interest. The Government has, we think, a unique position under the MarAd ship financing program.

We have heard a lot of discussion today about how the 1978 act was not designed to deal with this problem. Well, there was not a problem. There had been few ship guarantee defaults at that time.

In addition, there were substantial funds in the Loan Guarantee Fund. So, I submit that that situation is ancient history.

There are a couple of points that the Maritime Administrator made today, that as an operating company, Sonat Marine wants to second and support.

One of those is the adverse effect on the solvent operators who pay their debts, such as our company and many of the companies that you heard from today, and that is that these bankruptcy proceedings, no many how many sanctions you try to put in against the judges, go on and on and on.

The first thing that happens is that insolvent operators cut the rates. The next thing that happens is they stop maintaining their vessels, or just enough to get by.

The result is that they can charter this equipment to the same group of customers that the solvent operators are trying to charter their equipment to or lease their equipment to. We submit that this is an unfair advantage.

Now that the Treasury is funding these defaults, it is even more of an unfair advantage.

The second thing that we would like to speak to here today is there has been a lot of talk about the number of bankruptcies and the number of reorganizations, and so forth and so on. I am not saying that that is irrelevant. But I am saying that that is not a major concern.

A major concern that was touched on by the Maritime Administrator is this: that the insolvent or the operators in financial difficulty know, as MarAd knows very well, the leverage that they now have under the existing law with regard to going into Chapter 11.

Now, it did not come out particularly here. But Mr. Mills mentioned how long an operator has to deal with the problem before there is even any recourse by the Government. But, in addition, there is an opportunity and it has been taken advantage of by many companies, competitors of ours, to come in to MarAd and try to get their MarAd financing restructured. Obviously there are bond holders involved and it is sometimes quite an involved process.

These things are ongoing. But the situation is exacerbated by the fact that these financially troubled operators, in effect, have the Chapter 11 gun to MarAd's head, and sometimes the terms are particularly advantageous to these financially troubled operators, again, to the detriment of the solvent operators.

So, in summary, our position is that what is evolving is two sets of rules—one for the insolvent operators and one for the solvent operators.

We find a situation where we, the solvent operators, are being dragged down and we do not think that is what the ship financing program was designed to do, which is to wind up hurting all operators, including ourselves, who are paying their debts.

So we strongly support S. 1993, particularly MarAd's role.

Thank you.

[The statement follows:]

STATEMENT OF JOHN C. NEWCOMB, VICE PRESIDENT, SONAT MARINE INC., PHILADELPHIA, PA

I am John Newcomb, Vice President of Sonat Marine Inc. We are based in Philadelphia and are the largest independent transporter of petroleum products in the U.S. Our 33 tugs and 42 tank barges serve refineries and distributions centers on the East and Gulf Coasts, transporting approximately 225 million barrels of petroleum and petroleum products annually. Several of our vessels have been financed through the Title XI program—not because of the lack of availability of debt capital from commercial banks, but because of the need to maintain capital costs comparable to competitors who issue Title XI backed bonds. Our focus today is not the merits of the Title XI program or its administration, but rather the compelling need to correct a deficiency in the Bankruptcy Reform Act of 1978 (Pub. L. No. 95-598) that has impeded the Maritime Administration (MARAD) from effectively protecting its (and the U.S. taxpayers') security interests in marine equipment financed by Title XI backed bonds. Our company supports S. 1993 and urges its prompt enactment.

The Bankruptcy Reform Act of 1978 specifically exempts certain agencies of the federal government from the automatic stay provisions of the Bankruptcy Code. This premption empowers these federal agencies in specified cases to foreclose on assets in which the federal government has a security interest. The effect of this exemption is to give the federal government immediate access to the secured assets. This enables the creditor agency to by-pass the often lengthy proceedings in bankruptcy and to preserve its security interests which might otherwise be diluted by competing creditors or impaired by deterioration of the assets, occurring during the pendency of bankruptcy proceedings.

Our company believes it is desirable to enact this legislation as promptly as possible to achieve several important public policy objectives:

(1) The Title XI program has already experienced defaults in excess of $900 million since 1982, and the potential exists for additional defaults of $500 million. MARAD clearly needs the ability to promptly foreclose on Title XI equipment otherwise delays in foreclosure will only increase the immediate draws on the Treasury and probably will result in reduction in the ultimate recoveries by MARAD.

(2) The proposed amendment will restore MARAD's full exemption from the automatic stay provision which it held prior to the enactment of the 1978 Bankruptcy Reform Act, thus correcting what we believe to be an oversight in the 1978 Act.

(3) The proposed amendment would also curb a serious inequity which has befallen the financially solvent marine operators which must compete with Title XI assisted companies and which continue to operate under the protection of Bankruptcy Act reorganization. Since the equipment (financed with Title XI bonds) is oftern the debtors only revenue producing asset, the courts and trustees in bankruptcy keep the asset in operation as long as possible, rather than liquidate the equipment. While in operation during reorganization, the rates charged by the debtors for use of this equipment typically are set at an artificially low level because there is an effective moratorium on the debtors' debt service. This amounts to a subsidization of rates that severely disadvantages competing companies, such as ours, which continue to service their debt and meet all their other obligations. This amendment would correct this situation by giving MARAD the option to foreclose promptly on the equipment.

(4) The amendment also meets the important public policy objective of giving priority to the government's security interests. It must be remembered that MARAD provides the key credit facility in these marine equipment financings. Many Title XI financings were arranged with MARAD guaranteeing up to 87½ percent of the debt. The balance of the financing was often accomplished through limited partnership tax-shelter financings. These limited partners are wealthy 50 percent bracket taxpayers whose investments are often returned within the first few years of the project because of the generation of substantial non-cash deductions via the 10 percent Investment Tax Credit and the Accelerated Cost Recovery System. As a practical matter, this means that the limited partner equity investors have a very short term risk exposure (usually no more than five years at most)—defined primarily by the threat of tax recapture. In contrast to the equity partcipiants, MARAD is the party with the real risk, a risk which extends typically up to thirty years.

During the deliberations on the Bankruptcy Reform Act, there was concern that the benefits of reorganization should not be utilized by those partnerships whose main purpose in tax avoidance. Bankruptcy courts have noted that limited partnershps whose main purpose is tax avoidance are not appropriate candidates for the protection of the bankruptcy courts and thus foreclosure against their assets should be more readily allowed. *See* e.g. *In re Koopmans*, 22 Bankr. 395, 405-6 n. 18 (Bankr. D. Utah 1982). It is well known that numerous failing Title XI ventures have used precisely this type of investment vehicle. Accordingly, this amendment furthers this policy and will strengthen MARAD's hand in preventing parties from using the reorganization features of the bankruptcy laws to avoid the recapture of accelerated depreciation and investment tax credits as ordinary income.

For these reasons Sonat Marine urges prompt passage of this amendment so that MARAD may be better equipped to reduce some very large losses that are continuing to mount literally on a daily basis.

Senator STEVENS. Thank you very much.

Thank you all, gentlemen. We appreciate your courtesy in giving us your views.

I will prepare that bill and introduce it. You are not making the request that we do so, but we are going to do it anyway, Mr. Mills. We want to get the MarAd and Government agencies' comments and any others from interested parties. Then we will discuss the matter with the other members of the committee.

I do thank you all very much for your courtesy.

[Whereupon, at 10:53 a.m., the subcommittee adjourned, to reconvene upon the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF VINCENT CANNALIATO, JR., SMITH BARNEY, HARRIS UPHAM & CO. INC.

My name is Vincent Cannaliato, Jr. I am Senior Vice President and Manager of the Project Finance Group at Smith Barney, Harris Upham & Co. Incorporated in New York City.

Over the last 15 years, I have been deeply involved in many aspects of the maritime industry in the United States. In addition to structuring financings for and giving advice to a number of companies in the industry, I was formerly Chairman of the Ship Financing Subcommittee of the Maritime Advisory Board. I am currently Chairman of the Advisory Board of the Merchant Marine Academy at Kings Point, New York, which I have served on for 13 years.

I have worked closely with the Maritime Administration's Title XI program since 1971, first with Kidder, Peabody & Co. and since 1980 with Smith Barney. My experience with structuring and marketing Title XI transactions for the past 15 years has enabled me to gain a very solid understanding of the Title XI program and its ability to attract private capital for participants in an industry beset by a number of macroeconomic obstacles that are, on the whole, completely outside of the control of the industry.

You have asked me to address the effect of the Maritime Administration's ability to repossess collateral in the event of a default on the private lenders who participate in the Title XI program. It is my opinion that the repossession issue has absolutely no effect on the private capital markets. Indeed, the Title XI program is structured so that lenders have no reason to look through the United States government guarantee to the ultimate shipowner. This principle is clearly outline in offering circulars that describe Title XI transactions to the financial markets:

"Under Title XI of the Merchant Marine Act, 1936, as amended ("Title XI"), the Secretary of Transportation, acting by and through the Maritime Administrator (the "Secretary"), found, prior to entering into the Guarantee Commitment, that the property or project financed by the Bonds, were, in his opinion, economically sound, and, as provided under Title XI, the Secretary also found, prior to guaranteeing the Bonds, that the Shipowner had or will have the financial resources necessary for the adequate operation of the Vessel. Accordingly, it is the position of the Secretary that prospective purchasers of the Bonds will not review the financial condition (including the financial statements) of the Shipowner and that such prospective purchasers will rely completely upon the Secretary's determination regarding such financial matters." Thus, the Secretary assumes no lender will, at any time, look beyond the government guarantee.

Prior to a payment by the government, however, a lender is intricately involved in the default process. A borrower generally has a 30 day grace period after any payment date. After the 30 day period elapses, the trustee for the bonds has 60 days in which to demand payment under the guarantee. During the last half of this 60 day period, any lender can also directly demand payment from the government. Once a demand for payment is made, the government has 30 days to pay the outstanding principal and all accrued interest on the particular bond issue.

Therefore, although the lender has some control over the timing of the default declaration, such control is wholly independent of the Maritime Administration's ability to repossess the collateral securing the government guarantee. Thus, the lender is completely unaffected by any restrictions the Maritime Administration may face in repossessing the collateral.

I am pleased to present this testimony today and I now look forward to answering any questions you may have.

STATEMENT OF C.R. LUIGS, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GLOBAL MARINE INC.

Mr. Chairman and members of the subcommittee; my name is Russell Luigs. I am the Chairman, President and Chief Executive Officer of Global Marine Inc. which is headquartered in Houston, Texas. I would like to thank you for allowing me the opportunity to present Global Marine's views on S. 1993.

Global Marine has been an active participant in the Title XI program for over a decade. Indeed, that program has aided Global Marine in becoming a world leader in the design and operation of innovative, safe and cost effective drilling ships and ocean-going jack-up drilling rigs, and has thus aided Global Marine in taking an important step toward American energy self-sufficiency. During its long involvement with the Title XI program, Global Marine has worked closely with the staff of the Maritime Administration ("Marad") and has found that agency to be consistently cooperative and responsive to the needs of the offshore energy and merchant marine industries and truly to abide by its mandate to support those industries.

In this context, Global Marine would be derelict in its duty to such an industry supporter, as well as to its own stockholders and creditors, if it did not call to the attention of both Marad and this Subcommittee the dangers of S. 1993. In short, we think that passage of S. 1993 will not help Marad resolve its current problems with its Title XI program. Instead, it may well worsen Marad's financial position for the long term while seriously undermining other important national policies. For Global Marine, the passage of this bill in its present form could well completely deny the company the ability to reorganize in Chapter 11 and to continue operations.

GLOBAL MARINE INC.

A brief description of Global Marine will place our position in context. Global Marine Inc. and its consolidated subsidiaries provide high quality offshore contract drilling services and engage in oil and gas development, production and exploration. Global Marine owns or operates under long term leases a modern and diversified fleet of 34 offshore oil and gas drilling rigs and ships which are deployed all over the world. The fleet consists of twenty-one jackup drilling rigs, seven self-propelled drill ships, five semi-submersible drilling rigs, and one Concrete Island Drilling System ("CIDS"). (See Exhibit A.) [1]

Global Marine is a world leader in the design and operation of state-of-the-art oil drilling vessels. Global Marine has pioneered the development of units capable of year-round exploratory drilling in extreme climates, including the Arctic. An example of Global Marine's pioneering development emphasis, and of crucial importance to America's future oil independence, is its extensive research and development for exploration and production activities in one of the United States' most important energy frontiers—Alaska.

Global Marine has consistently maintained one of the highest rates of rig utilization in the offshore drilling industry, combined with one of the highest levels of rig rental "day rates" (See Exhibit B.) It has continued to maintain these high utilization levels and day rates since it suspended most debt service payments on July 1, 1985, and since January 27, 1986, when it filed for voluntary reorganization under Chapter 11. While achieving these excellent marketing and operational results, Global Marine's management initiated wide-ranging cost cutting programs, resulting in actual savings from budget during 1985 in excess of $27,000,000. (See Exhibit C.)

Global Marine has achieved these utilization and day-rate levels through a consistent strategy of delivering a superior service at competitive, but clearly top-of-the-market prices. This strategy has been both implemented and facilitated through what we believe to be one of the most sophisticated marketing programs in the industry.

Global Marine has pursued its goal of high quality, innovative service through the difficult economic times which have beset the entire offshore oil industry. Global Marine thought it would be able successfully to restructure its operations without the assistance of the bankruptcy laws. With the cooperation of all its creditors, including Marad, Global Marine worked toward that goal for seven months in 1985. Only the unprecedented collapse of oil prices at the end of the year forced Global Marine to seek protection under Chapter 11.

While there can be no guarantees, Global Marine went into Chapter 11 with the intention of coming out of it, repaying Marad and its other creditors in accordance with the Bankruptcy Code, and saving for the United States one of the highest quality operators in the worldwide offshore oil and gas industry. Adoption of S. 1993 could deny it this opportunity.

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[1] The exhibits were not reproducible.

THE ISSUES RAISED BY S. 1993

In analyzing any legislative proposal it is essential first to identify precisely the problem that is sought to be solved by the proposed legislation. Then the legislation msut be carefully examined to determine whether it fixes the problem, and whether it adversely affects other important public interests in the efforts to provide such a fix. From our long experience in the offshore drilling industry, we must conclude that S. 1993 does not fix the real problems facing the offshore drilling and merchant marine industries, and may cause irreparable damage to public policies favoring business reorganizations generally and the energy self-sufficiency of the United States.

The real problem for Marad is the unprecedented number of Title XI defaults and the attendant high level of guarantee payments by Marad. This in turn is caused by the real problem for Marad's constituent industries: unprecedented and severe cyclical downturns, especially in the offshore energy industry.

However, instead of focusing on cures for these fundamental problems, S. 1993 focuses the problem on (1) the alleged obstacle posed by the automatic stay provisions of the Bankruptcy Code of Marad's efforts to recoup Title XI guarantee pay-outs and (2) the alleged cost advantage companies in Chapter 11 reorganization supposedly have over non-defaulting competitors. Not only does S. 1993 fail to solve, or even to address, the more fundamental problems stated above, but its adoption would in fact worsen Marad's recoupment position in the bankruptcy context. Further, we think that the so-called unfair cost advantage argument, which has been pressed on Marad by some industry members, lacks merit. Indeed, even if such a cost advantage did exist giving rise to potential price-cutting, allowing Marad unilaterally to take vessels out of the market, or perhaps take them out and put them back in at "fire-sale" prices, would result in even worse market distortions.

MARAD'S POSITION IN REORGANIZATION PROCEEDINGS

We understand and agree that Marad's objective as Title XI creditor should be to maximize the money it recovers from Title XI debtors. In that regard, Marad is in the same position as any other secured creditor in a Chapter 11 reorganization. The course of action that would be allowed Marad under S. 1993 must be judged in light of that objective.

In testifying before the Subcommittee on March 21, 1986, the Maritime Administrator framed the problem the agency feels it is facing as follows: "The current situation is very serious, and one of our major problems in managing the problem is the bankruptcy law. It prohibits us from foreclosing on the vessel used as security for the Title XI debt." Marad also asserted the Secretary of Transportation is "effectively blocked" from foreclosing on its Title XI security by the automatic stay provisions of the Bankruptcy Code and must resort to the "costly, time-consuming, and arduous procedures" required to lift the automatic stay.

Marad is making the assumption that extraordinary relief from the automatic stay would improve its recoveries in Title XI defaults. We believe the opposite is true. By utilizing the unilateral "retaking" right in S. 1993, Marad would be foregoing carefully crafted and time-tested creditor protection mechanisms already in the bankruptcy law and would receive liquidation values on its collateral which are almost always lower than the going-concern values that can be obtained if a debtor is permitted to retain its equipment and reorganize. We urge Marad and this Subcommittee to reconsider Marad's request for exemption from rules that apply to virtually all other government agencies and private creditors and which appear to serve well the creditors of every other industry.

The current automatic stay provisions provide protection for Marad's recovery efforts. We can only believe that Marad is being urged by outside forces to ignore the fact that creditors are entitled to "adequate protection" as the *sine qua non* of the automatic stay. A debtor's right to continued possession of its property depends on its ability and willingness to provide Marad and its other secured creditors with protection adequate to maintain the value of their collateral. If a debtor cannot persuade the court that a creditor's collateral is adequately protected then the stay can be lifted. Thus, bankruptcy law already affords all creditors, including Marad, alternative relief: adequate protection or foreclosure rights. We urge Marad not summarily to discard or ignore this fundamental concept of adequate protection.

A summary retaking of collateral could be economically disastrous for Marad given the current alternatives to leaving a reorganizing debtor in possession of the collateral. Taking back equipment that can only be sold at fire sale prices, or "warehousing" such equipment at signficant out-of-pocket cost until the market improves, are very poor alternatives to receiving adequate protection while allowing a debtor to maximize the chances for full recovery and to preserve much higher "going concern" values of its equipment. We understand Marad's desire to recoup money it is owed as soon as possible. But to concentrate solely on the "quick-fix" of a special exception to the bankruptcy automatic stay rule hurts both the industry and Marad.

Marad has a number of alternatives it if by-passes the present Bankruptcy Code and prematurely repossesses vessels and rigs from debtors in reorganization. However, each of these alternatives presents serious problems and would be much more harmful to the U.S. Treasury and the U.S. taxpayer than allowing a debtor to operate its equipment while providing adequate protection.

First, Marad can sell the equipment domestically at distress "fire-sale" prices, yielding it only a few cents on each dollar. Sales of assets which retain most of their useful economic life at the current depressed prices is economic suicide for any lender, and is particularly inappropriate when the real lender is the U.S. taxpayer.

Second, Marad can attempt to lay-up vessels and stack rigs awaiting an upturn in market prices. The costs of carrying out this option would be astronomical. In the rig context, the up front cost of "demobilization" and of preparing one rig for stacking could be as much of $1,500,000. Once the rig has been moved to the stacking area and prepared for stacking, the additional annual expense for each of the over 50 Marad-financed drilling rigs could range from $750,000 to $1 million per rig. If Marad does what certain industry members will surely pressure it to do—summarily take off the market all equipment of debtors in reorganization proceedings—the cost of lay-up and stacking of drill rigs, supply boats, tugs, barges and blue water carriers involved in chapter proceedings will be unthinkable. We simply cannot conceive of where Marad would be able to get the funds necessary for such an undertaking.

Third, Marad could attempt itselt to employ repossessed equipment by hiring someone to manage and operate such vessels and rigs. This could lead to out-of-pocket government expense and would also mean that U.S.taxpayers would be supporting a government agency inappropriately engaging in what should be purely private sector activities.

The fourth alternative may be the most dangerous. Marad has stated its intention to seek to sell the repossessed vessels in foreign markets, on the basis that this would avoid undesirable competition with U.S. companies and at the same time recoup part of the government's losses. However, the market for vessels, particularly in the oil exploration and production industry, is truly world-wide, and any utilization of the vessels stands to have some competitive impact in the industry. Also, employment of U.S. citizens at home and overseas is lost whenever a vessel is removed from U.S. registry and placed under a foreign flag.

But more serious is the detrimental impact foreign sales of advanced oil development equipment would have on U.S. energy policy. The long-range security and well-being of the United States unquestionably requires energy self-sufficiency. Yet Marad's plans call for the sale of some of this country's most technologically advanced oil drilling equipment to foreign buyers for prices that in today's market would be practically give-aways. When the highly cyclical oil industry is once again on the upswing, foreign interests would have superior equipment at a minimal capital cost. Meanwhile, U.S. companies would have to start from scratch to build new equipment at high cost. Reentry of U.S. companies into the intensively competitive international oil offshore exploration and production industry would be seriously delayed, and perhaps economically impossible.

Such a policy would play directly into the hands of foreign oil interests who can and will manipulate their monopoly position to achieve maximum political and economic power at the expense of the United States. We all remember the oil crisis, gas lines, and spiraling inflation. Yet S. 1993 espouses a government policy that could undo all the progress we have made toward energy security.

THE ALLEGED COST ADVANTAGES OF A REORGANIZING DEBTOR

The assertion that companies in reorganizations under Chapter 11 are aggravating the already depressed market because they can set prices without having to cover the cost of servicing their capital debt has not been substantiated. Debtors in Chapter 11 do not have a free hand to price at below cost. Creditors of a company in reorganization and the bankruptcy court demand that the debtor maximize income. Neither can be expected to tolerate pricing that would reduce a debtor's cash flow.

Global Marine's own pricing practices clearly demonstrate that in Global Marine's experience this allegation of unfair price-cutting is not true. Exhibit B to my testimony illustrates that Global Marine's day rate and equipment utilization levels have consistently been among the highest in the industry and remain so. The industry-wide decline in day rate levels is attributable to well documented market factors including falling oil prices, not to the alleged cost of debt advantage.

Indeed, S. 1993 could cause far greater harm to the competitive market place than any speculative benefit it would supposedly offer in regard to such alleged cost advantages. The industry supporters of the bill want Marad to have and exercise the power to get equipment "off the market" in a hurry. This course of action would almost guarantee increased market concentration. Such action by a government agency clearly runs contrary to the basic philosophy of the Administration of minimizing the government's interference with business.

RETROACTIVE APPLICATION OF S. 1993 WOULD BE GROSSLY UNFAIR

To apply S. 1993 retroactively to a company, such as Global Marine, which has already filed under Chapter 11, would be inequitable, unfair and contrary to long-standing bankruptcy and merchant marine policy.

Global Marine entered reorganization proceedings, after seven months of negotiations with all of its secured creditors, including Marad, relying on the rights afforded by existing law for it to continue in business by retaining possession of and continuing to operate its vessels, as long as it provided adequate protection to its secured creditors. Passage of S. 1993 could well kill Global Marine's opportunity to successfully reorganize under the bankruptcy laws as they are presently written. Global Marine's other creditors, as well as its investors, cannot fairly be deprived now of the opportunity for maximum protection of their investments through reorganization.

Changing the rules in the middle of the game for companies already in chapter proceedings, especially where the change would have such irreversible, harmful repercussions, goes against fundamental American concepts of due process and fair play.

The fundamental unfairness of retroactive application of changes in law is well recognized by Congress. In both maritime and bankruptcy legislation, Congress has consistently and explicitly declined to apply changes in the law retroactively. If Congress proceeds with enactment of S. 1993 it should at the very least maintain this tradition of fairness by refusing to permit retroactive application of changes.

CONCLUSION

S. 1993 would significantly increase the possibility that every Chapter 11 reorganization of a U.S. shipowner or rig operator will become a liquidation proceeding. Since the bill would allow Marad and all other U.S. vessel lenders to pierce the automatic stay and retake their collateral, it would deprive the entire U.S. merchant marine and offshore energy industries of the fundamental right to attempt to salvage an ongoing, productive business through a Chapter 11 reorganization. In short, this bill may force companies facing temporary difficulties in a cyclical market downturn to liquidate. The results—loss of jobs, losses for creditors and shareholders and economic dislocations—are unacceptable and would reverse a carefully balanced national bankruptcy policy favoring reorganizations as an alternative to liquidations. There is no reason why the off-shore energy and merchant marine industries should be singled out for such treatment.

Mr. Chairman and members of the Subcommittee, Global Marine urges you and Marad not to pursue S. 1993 in its present form. As that bill now exists, it would disrupt sound bankruptcy policies without providing the benefits claimed by its proponents.

It would result in increased short term and long term costs to the taxpayers. It would potentially deal a death blow to good companies which are attempting to reorganize. Finally, it would put Marad in the impossible position of manipulating the market and being a vessel broker. That agency has served the offshore energy and merchant marine industries too well in the past to be put in such an untenable position. We cannot believe that Marad itself, as a purely promotional agency, wants the awesome responsibility of determining in its sole discretion what companies live and what companies die in these industries.

Finally, in no event should any such change in law break with precedent and be applied retroactively in contravention of fundamental doctrines of due process and fairness.

STATEMENT OF PETER J. FINNERTY, VICE PRESIDENT—PUBLIC AFFAIRS, SEA-LAND CORP.

It is not hyperbole to say that the Title XI program, which seemed on the surface for so long to be sound, has been devastated by the continuing series of defaults by U.S.-flag vessel owners over the last year. Over $600 million has been paid out just since the beginning of this year, a portion of well over $1 billion of pay-outs over the past three years. That represents a total depletion of the fund that was built up from fees paid by Title XI borrowers over a period of 50 years, plus a net direct drain on the U.S. Treasury of another $795 million. And MarAd projects that total aggregate borrowings from the Treasury could very likely exceed $1 billion within several months. Nearly a half billion dollars worth of Title XI secured vessels remain tied up in bankruptcy proceedings at this moment.

Yet in the face of these facts, MarAd has often been preventd, by effect of an inadvertent change in law when the Bankruptcy Code was revised in 1978 (P.L. 95-598), from taking advantage of the security theoretically provided in the balance of the Title XI transactions. Since a vessel operator that defaults on its loan obligations is also very frequently a vessel operator teetering on or entering bankruptcy, MarAd faces this dilemma often. When prevented from foreclosing by virtue of the automatic stay in bankruptcy, MarAd is left paying out in full to the bondholders—the interests of the bondholders and their trustee are thus statisfied and dissolve—with nothing in return. By being unable to foreclose, MarAd suffers in two ways: first, it is left with a right to collect the debt and any accured interest but with very little practical chance of collection, except perhaps at a dismal post-bankruptcy reorganization discount; second, it is unable to repossess and sell the vessels so as to cut its losses. MarAd, of course, can make advances (as it has done too often) to prevent a carrier from defaulting and/or seeking bankruptcy protections; but such a solution is a poor alternative because it is only temporary and merely serves to increase markedly MarAd's exposure. These effects are undoubtedly by now obvious to the Committee since they are the problems motivating the Administration to seek statutory change in this legislation.

But what the members may not have fully focused on until now is the detrimental competitive effect of leaving the defaulting vessel operators free to continue to operate those vessels while in bankrupt status without the burden of debt service. Such operators have an enormous incentive to slash their rates, they are able to do so because, whatever the theoretical nature of their obligation to reimburse MarAd for their defaulted debt (with interest), it is a deferred obligation, it forces no drain on current cash flow, and it is almost certain to be discounted if it is even honored at all. In this situation, rate-cutting—even to the point of pricing below the cost of prividing the service—is not only possible; it is likely. Such activity wreaks havoc on the trade for carriers who responsibly incurred the cost of building U.S. ship and who reliably service their own debt. It is just not fair—and it is bad economics, bad financial policy, and bad maritime policy—to let such operators avoid their responsibilities to reimburse or satisfy the federal government, and thereby the taxpayers, while at the same time also permitting them to victimize hitherto successful carriers who do abide by their obligations. It also is probably not overstating the case that such a situation could risk a domino effect, whereby other carriers are driven to a strained cash-flow position in which further Title XI loan defaults could be triggered.

This is a matter unfortunate recent experiences amply illustrate the problem and in which some foresight can mitigate further problems. As was emphasized in a colloquy between Senators Long and Inouye in the course of Senate floor discussion (129 Cong. Rec. S14182-83 (Oct. 10, 1984)) over the bill (H.R. 5833) that Congress enacted in October, 1984 (P.L. 98-595) to tighten Title XI loan commitment criteria: it makes sense to anticipate and avoid those situations in which loan defaults allow cheap equipment to stay in the trades, destroying competition. Whether the creap equipment results from MarAd to quickly selling foreclosed equipment under-value in a soft market, or from letting the preexisting owner continue operation after default without debt service, the effect is the same: honest, successful competitors, working hard to meet their obligations on a timely basis and earn a profit are unfairly undercut.

Congress no longer can afford to ignore (warnings were expressed here at least by the 97th Congress) the disastrous effects of extravagant Title XI assistance and resultant over-capacity in various U.S. domestic trades. For the foregoing reasons, Sea-Land Corporation supports S.1993.

PENROD DRILLING CO.,
Dallas, TX, April 18, 1986.

U.S. SENATE,
Committee on Commerce, Science and Transportation, Subcommittee on Merchant Marine, Hart Senate Building, Washington, DC.

LADIES AND GENTLEMEN: Penrod Drilling Company is engaged in the business of drilling oil and gas wells on land, in inland water offshore. Although not used for the transfer of goods or passengers, drilling rigs used in inland waters and offshore are considered vessels under the Merchant Marine Act of 1936, and various of Penrod's financing arrangements are, or could be, subject to the provisions of S. 1993.

Penrod has no objection to premitting the Secretary of Transportation, either under the proposed provisions of S. 1993 or some similar arrangement, to exercise full mortgage foreclosure rights against debtors who have filed for bankruptcy in order to protect the interest of the United States under the loan guarantee program of Title II of the Merchant Marine Act of 1936. Unlike a private lender, the Secretary of Transportation under the Title II program is using public money furnished by United States taxpayers, and should be entitled to exercise the full rights which it has under its financing agreements, and which the borrowers freely entered into, if it deems the exercise of such rights to be in the best interests of the United States. Such exercise should not be subject to the restrictions of the bankruptcy laws.

Title II financing offers very favorable terms which are not normally available in the private market. In essence, Title II financing amounts to a form of government subsidy to maritime commerce, and under these circumstances it is appropriate to grant the Maritime Administration the extraordinary protection which S. 1993 would provide, but there is no justification for placing all preferred ship mortgage holders in this position.

Penrod strongly objects to any proposal which would allow private lenders holding ship mortgages on vessels to foreclosure notwithstanding the protections of the bankruptcy laws. In contrast to the Secretary of Transportation, private lenders do not lend public money furnished by United States taxpayers and there is no policy reason why these private lenders should be free of the obligations of the bankruptcy laws when private creditors in all other kinds of transactions are not in such position. Allowing all preferred ship mortgage holders to foreclose in spite of the bankruptcy stay would undoubtedly prejudice the rights of all other creditors of the bankrupt estate.

For the above reasons we respectfully request that you consider limiting the effect of S. 1993 to the Maritime Administration.

Very truly yours,

MARSHALL BALLARD, *General Manager.*

RIVERWAY,
March 31, 1986.

Senator TED STEVENS,
Chairman, Senate Merchant Marine Subcommittee,
Senate Commerce Committee, Washington, DC.

DEAR SIR: Thank you for contacting our president, Grayson Tuck. He has forwarded your request for comment on S. 1993 to me for reply.

Riverway Co., founded in 1937, is an inland waterway transportation company transporting unregulated dry bulk commodities on the Inland Waterways System of the United States. The currently owned and controlled Riverway fleet consists of 440 barges and 11 line boats.

Also, Riverway Barge Co., a wholly owned subsidiary, shipping regulated commodities with common carrier rights on the entire Inland Waterways System, including the Gulf Intracoastal Waterway. In addition, Gulf Atlantic Tranport Corp., a wholly owned subsidiary based in Jacksonville, FL., provides ocean barge transportation carrying commodities from New Orleans and Mobile to Puerto Rico and back.

Riverway Co. strongly opposes passage of S. 1993 which as we understand it would enable the Maritime Administration and other secured creditors to by-pass the bankruptcy courts in Chapter XI proceedings in foreclosing on equipment.

We find this to be most objectionable as it would mean that companies operating any type of vessel would, as a practical matter, be deprived of the opportunity to reorganize and rehabilitate themselves under the protection of Chapter XI of the bankruptcy laws. This would clearly work against barge companies in many ways. Not only would it deny our industry the right to utilize the bankruptcy laws, if necessary, but also it would clearly inhibit our ability to obtain outside investment funds, particularly during this time when the barge industry is severly depressed. We are certain that no one would be willing to provide unsecured funds or credit to a barge company if they know that another creditor or creditors of the company had the right to seize its equipment to the detriment of all unsecured creditors.

Passage of this bill would just add one more problem adversely affecting the ability of companies such as ours to survive. We urge that it not be approved.

If you have any questions, please contact me at (612) 893-8745.

Sincerely,

Thomas L. Grupp, *Executive Vice President.*

[S. 2436, 99th Cong. 2d sess.]

A BILL To preserve the rights of the United States as a mortgagee under title XI of the Merchant Marine Act, 1936

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Section 362(b) of title 11, United States Code, is amended by substituting "; or" for the period at the end of paragraph (11) thereof and adding new paragraphs (12) and (13) thereto reading as follows:

> "(12) under subsection (a) of this section, of the commencement or continuation of an action by the Secretary of Transportation to foreclose a mortgage on a vessel under the Ship Mortgage Act, 1920 (46 App. U.S.C. 861 et seq.), held by the Secretary under section 207 or sections 1101 through 1110 of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271-1979e); or
>
> "(13) under subsection (a) of this section, of the commencement or continuation of an action by the Secretary of Commerce to foreclose a mortgage on a vessel under the Ship Mortgage Act, 1920 (46 App. U.S.C. 861 et seq.), held by the Secretary under sections 1101 through 1110 of the Merchant Marine Act, 1936 (46 App. U.S.C. 1271-1279e).".

Sec. 2. The amendments of section 362(b) set forth in section 1 above shall apply only to filings referred to in section 362(b) which are made after the effective date of this amendment.

General Counsel of the
U.S. Department of Commerce,
Washington, DC, June 16, 1986.

Hon. Ted Stevens,
Chairman, Subcommittee on Merchant Marine, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

Dear Mr. Chairman: This is in response to your request for the views of the Department of Commerce on S. 2436, a bill "To preserve the rights of the United States as a mortgagee under title XI of the Merchant Marine Act, 1936."

S. 2436 is intended to preserve the rights of the United States as a mortgagee under title XI of the Merchant Marine Act, 1936, as amended, by exempting the foreclosure of a preferred ship mortgage held by either the Secretary of Transportation or the Secretary of Commerce from the automatic stay provisions of title 11, United States Code (Bankruptcy Code).

S. 2436 is identical to a legislative proposal offered by Mr. Thomas L. Mills during a March 21, 1986, Subcommittee hearing on S. 1992 and S. 1993, bankruptcy reform legislation. We are enclosing a copy of our response to your previous request for our comments on his proposal.

We have been advised by the Office of Management and Budget that there is no objection to our submission of this report to the Congress from the standpoint of the Administration's program.

Sincerely,

Douglas A. Riggs.

Enclosures.

DEPARTMENT OF COMMERCE COMMENTS ON BILL DRAFTED BY THOMAS L. MILLS, REPRESENTING APEX MARINE CORP. AND CROWLEY MARITIME CORP. (WHICH IS IDENTICAL TO S. 2436)

The bill proposed by Mr. Mills would attempt to preserve the rights of the United States as mortgagee under Title XI of the Merchant Marine Act, 1936, as amended, by exempting the foreclosure of a preferred ship mortgage held by either the Secretary of Transportation or the Secretary of Commerce from the automatic stay provisions of the Bankruptcy Code. The comments of the Department of Commerce on the proposed bill are as follows:

(1) Granting the Secretaries the right only to commence or continue a ship mortgage foreclosure action is vague and ambiguous. In litigation, to "continue" is to impose a hiatus on a proceeding. If the right to continue does not include the right to conclude the foreclosure action by selling the vessel and receiving the sale proceeds in satisfaction of the Secretary's secured claim, then this proposal will not have the desire effect of returning funds to the Treasury. The bill should read ". . . commencement, continuation and conclusion of an action by the Secretary . . . to foreclose . . . " in both subsections (12) and (13).

(2) The words "preferred ship" should be inserted between the words "foreclose a" and the word "mortgage" in both subsections (12) and (13).

(3) The Ship Mortgage Act, 1920, is incorrectly cited. Delete "861 et seq." and replace it with "§§ 911-984" in both subsections (12) and (13)

(4) In subsection (12), there are two typos in the citation to the Merchant Marine Act, 1936, Change "1979e" to read "1279c".

(5) In subsection (13), insert the words "or a moartgage, deed of trust, or other security interest on a fishing facility" between the comma after the cite to the Ship Mortgage Act, 1920 and the word "held".

(6) In subsection (13), there is a typo in the citation to the Merchant Marine Act, 1936. Change "1279e" to "1279c".

We have previously gone on record in favor of amending Section 1110, rather than Section 362, of the 1978 Bankruptcy Code as the preferred method of resolving our problems with the automatic stay. Hearings on H.R. 5029 before the Subcommittee on Merchant Marine of the House Committee on Merchant Marine and Fisheries, 98th Cong., 2d Sess., 149 (April 10, 1984) (Statement of James E. Douglas). The reasons for this preference include the fact that Section 1110 already exists in the Code and attempts, though ineffectively, to deal with this ship mortgage problem. In addition, Section 1110 contains the provision for a 60 day cooling-off period in which settlement may be negotiated to the advantage of all parties. Section 362 contains no such institutionalized negotiating period and, if amended as proposed by Mr. Mills, would duplicate the intended purpose of Section 1110. This Agency continues to favor amendment of Section 1110 and the addition of a corresponding section to Chapter 13 as the preferred means of resolving this issue.

DEPARTMENT OF COMMERCE RESPONSE TO STATEMENT AND SUPPLEMENTAL STATEMENT BY PROF. LAWRENCE P. KING FOR THE NATIONAL BANKRUPTCY CONFERENCE

Professor King thoroughly outlines how secured creditors are supposed to be adequately protected under the Code and the parameters for obtaining relief from the automatic stay. From the viewpoint of those in the trenches, however, the expectations raised by his interpretation of the Code far exceed the reality that reorganization plans are being confirmed over the Government's well-founded objections, that is, these reorganizations are failing because the debtors cannot both bring arrearages current and adequately protect the interests of their secured creditors. These reorganization failures result in the ultimate loss of the business venture and more than a year's additional delay before the Government can realize on its collateral, during which the value of its interest deteriorates due to lack of adequate protection. If the Government exercises its right to appeal an adverse ruling on a relief from stay motion, the agency is still faced with the same amount of delay while the appeal makes its way through the system.

Professor King then discusses three reasons why he believes that Congress in 1978 affected the status of the Government as a creditor. His first contention, that the deletion of the fifth priority for payment of non-tax debts owed the Government pursuant to Section 64(a)(5) of the Bankruptcy Act of 1898 compares apples to oranges. As stated by Professor King, that priority was for unsecured debts, and was based on a belief that the Government as unsecured creditor should stand on the same plane with other unsecured creditors. He applies the same rationale to secured debts without corresponding support in the legislative history for that position.

By attempting to put the Government on the same plane as other secured creditors, Professor King ignores two major distinctions between the Government in general, the Federal Ship Financing Fund in particular, and other secured creditors. First, what is sought to be protected here is not a profitable commercial financial position. These are public funds, used to administer a program designed to assist the vessel-owning segment of the public. Second, the Fund is self-supporting, and so is dependent on return on irretrievably defaulted collateral for its continued viability. These, therefore, are not the "ordinary debts," referred to in the case *Davis* v. *Pringle* cited by Professor King, collection of which the federal government should not have priority over other creditors. They are debts which have contributed significantly to the insolvency of the system intended to assist others to receive long-term financing. The effect of these debtors' failure ot pay goes far beyond their relationship with the federal government as secured creditor. These are, therefore, quite extraordinary debts.

In similar fashion, his assertion that the foreclosure priority for ship mortgage holders would damage other creditors is baseless, at least in the climate of the present vessel market. Since vessels are worth much less than their mortgaged debt on today's market, and because debt service cannot be maintained at the contracted level, no other creditor stands to benefit from retention of the vessel by its owner in any case. If the owner cannot meet its debt service on the vessel, it surely cannot pay other creditors.

In his second argument for congressional restriction of federal foreclosure authority, Professor King states that a provision similar to Section 1110 of the 1978 Code existed in Chapter X of the pre-1978 Code. He states that Section 1110 was included in the 1978 Code only because of "heavy lobbying by equipment manufacturers." We believe that the legislative process is designed to respond fairly to lobbying and that the results reached through that process are not necessarily bad or improper or in contravention of true congressional intent. The fact remains that a provision accomplishing the purposes of Section 1110 was and is a part of both the pre- and post-1978 Code and in order for it to remain as a part of the 1978 Code, a majority had to vote for it in Congress. Congressional intent, therefore, was in favor of its inclusion in the 1978 Code, not against it.

Professor King's third and, as he states, most important point is that Bankruptcy Rules in existence from 1974 to 1978 imposed an automatic stay on enforcement of liens such as foreclosure of preferred ship mortgages held by the federal government, despite the language of Section 703 (11 U.S.C. § 1103) of the pre-1978 Code which prevented the Bankruptcy Courts from enjoining those foreclosures. Section 703 was added to the 1898 Act in 1938, the same year that the Title XI guaranty program came into effect. Professor King, therefore, neglects the 36 years prior to 1974 during which Section 703 did empower the federal government to foreclosure on its preferred ship mortgages. The Agencies were, therefore, not incorrect in stating that there was a absolute right to foreclosre pre-1978.

The Agencies support the modification of the absolute right to foreclose. As stated by Professor King, Section 703 was not carried over into the 1978 Code because Congress believed that "reinstituting an absolute right for an agency of the government to seize vessels is unwise and unnecessary." Such opposition to an absolute right is well met by the cooling-off provisions of both the present Section 1110 and S. 1992 and S. 1993.

Comments by both Congressman Edwards and Senator DeConcini reflect that both the House and Senate agreed that the new Bankruptcy Code should not retain the provision allowing the Government to take "unilateral action" to protect its interest, but rather, the Agency, like other secured creditors, would be entitled to repossession of its security, i.e. the vessel, after allowing sixty days during which the Agency and the vessel owner can work out their differences prior to the ripening of the Agency's right to foreclose the ship mortgage. 124 Cong. Rec. H-11, 109-11, 110 (daily ed. Sept. 28, 1978); 124 Cong. Rec. S17,425 (daily ed. Oct. 6, 1978).

The 60-day period may be extended by mutual agreement between the trustee and secured creditor. In addition, pursuant to the terms of 11 U.S.C. § 1110(a)(2)(B)(i) and similar terms in both S. 1992 and S. 1993, if the default does not occur until after the order for relief, the cooling-off period can stretch to as long as 89 days. Thus, while Professor King argues convincingly that Congress intended to abolish the absolute federal right to foreclose, he does not counter the proposition that Section 1110, and its limited exempt to the automatic stay, was fully intended by Congress. S. 1992 and S. 1993 conform to that intent by providing for a continuation of the limitation on the exemption from the automatic stay.

There are certain additional factors not considered by Professor King which argue for the right to foreclose if settlement is not reached during the cooling off period. Prof. King ignores the fact that the federal agencies holding these ship mortgages are most definitely not interested in foreclosing them except as a last resort. This reluctance is brought on by the fact that, at foreclosure sale, fishing vessels, for example, only bring an average of 50 cents on the dollar, leaving massive deficiencies as unsecured claims, which are low in priority for payment from the debtor's estate. Thus, the agencies are very willing to negotiate for any kind of reorganization plan that will increase their recovery beyond 50-60 cents on the dollar, even if the recovery is to be paid over time.

The cooling-off period is also helpful in bringing the vessel owner to the table with a reasonable offer if such is possible, because it only has 60 days in which to reach an accord with the creditor. What Professor King neglects, then, is that S. 1992 and S. 1993 will foster settlement because the alternatives present unpalatable consequences to both the debtor and creditor, foreclosure being unpalatable to both and an ill-founded and failure-prone reorganization plan being unpalatable to the federal mortgagee.

A second factor Professor King neglects is that there are relatively few of these cases. As the Department of Commerce statistics submitted to the Committee demonstrate, fully one third of its guaranty redemptions are worked out short of foreclosure or bankruptcy, and less than one in eleven of its redemptions have resulted in an attempted reorganization. The low number of attempted reorganizations plus the advantage to the Government entailed in settling with the debtor for a recovery greater than that attainable at foreclosure sale, as discussed above, will not result in a wholesale seizure of vessels in bankruptcy. As noted above, the vessel market simply will not accept a large number of vessels for sale.

DEPARTMENT OF TRANSPORTATION,
July 2, 1986.

Hon. TED STEVENS
Chairman, Subcommittee on Merchant Marine, Committeeon Comerce, Science and Transportation, U.S. Senate, Washington,D.C. 20510

DEAR MR. CHAIRMAN: Thank you for providing us an opportunity to respond to Mr. Thomas J. Faust's letter to you dated March 20, 1986.

We have been advised that Mr. Faust was recently indicted by a Federal Grand Jury in the United States District Court for the Northern District of California. It is our understanding that the indictment contains six counts related to criminal fraud, as well as embezzlement of funds belonging to the United States? In view of the fact that the matter is in litigation and is belng handled by the United States Attorneys office, we feel it would be inappropriate to address Mr. Faust's letter insofar as it pertains to his personal involvement with Tractug Associates.

Insofar as the letter pertains solely to Tractug Associates, and not to Mr. Faust personally, we note that the basic contentions in the letter were exhaustively considered by the United States Bankruptcy Court in San Francisco and were found to be without merit. Indeed, in making that finding the court ruled that the automatic stay could be vacated, thus allowing the Government to enforce its secured lien through foreclosure against Tractug's defaulted title XI vessels.

In addition, Tractug filed its "economic injury" claims as a lawsuit against the United States in the aforesaid bankruptcy court, as well as filed the claims as affirmative suits and counterclaims in three United States district courts and the United States Court of Claims. The Court of Claims dismissed the suit filed in that court upon motion of the Government. Tractug voluntarily dismissed its claims in the three district courts. Finally, the bankruptcy court dismissed the suit filed in that court, finding that the suit was without merit and that it was " * * * created by the imagination of (Tractug's) counsel. * * * "

We believe all of Tractug Associates' claims have been made known and considered by innumerable Federal courts. The actions taken by the various courts in rejecting those claims reflect the fact that full considertion has been given to Tractug's assertions, and that all of those assertions have been deemed groundless. In view of the rulings of the courts, we feel that little would be gained by responding further to tractug's claims.

Sincerely,

JOHN GAUGHAN, *Maritime Administrator.*

TRACTUG ASSOCIATES
San Francisco, CA, March 20, 1986.

Hon. TED STEVENS
Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC

DEAR SENATOR STEVENS: I have recently been invited to comment on the proposed legislation.

This proposed special interest legislation if enacted would be a travesty of American justice. The bill's proposed existence is only because of a badly administered title XI program in which overly prmissive loan officers induced investors to invest funds because of government oan guarantees. Now that the government has over stimulated the market, ie. caused supply of vessels and drilling rigs to exceed demand, they want the privilege of seizing these assets.

Congress should not enact this legislation. MarAd should not be allowed to have it both ways. If MarAd is going to venture into commercial transactions it should be required to play by the same rules that everyone else is subject to.

This proposed legislation is designed to give MarAd special treatment under the Bankruptcy laws. It would circumvent the underlying goal of those laws—the successful reorganization of troubled companies. By allowing MarAd to seize its collateral 90 days after a Chapter 11 filing, a troubled company has little hope of successful reorganization—to the detriment of its other creditors. MarAd, like other creditors should follow the procedures set fthin the Bankruptcy laws.

This proposed legislation would allow MarAd to profit from its own mistakes. There is little question that the title XI program has been maladministered. MarAd has willy-nilly guaranteed financing on almost anything without regard to the purposes and policies of the Merchant Marine Act. The guarantees extended to LNG carriers and river barges are just two examples. Neither fosters the goals of section 101 of the Act and both have been colossal financial failures. MarAd wants to again disrupt the normal process, ignore congresionally mandated policies, and to what it pleases.

Tractug Associates provides a good case study of Mses. Tractug built, with the help of title XI a fleet of the most modern, safest and technologically advanced tugs in the United States. Even today there are only a handful of these tugs in the U.S. (although they are the state of the art standard in the rest of the world).

Tractug's tugs met the goals of the Act and were properly granted the title XI guarante However, after Tractug got its funding, and in the face of a growing surplus of tugs around the U.S., MarAd continued to provide title XI guarantees to old obsolete designs which did nothing to further the goals of the Act. In fact MarAd granted so many guarantees (138 additional tugs and tug/supplies) that it created a surplus in the market and doomed the economic viability of the Tractug project (which economic viability MarAd had previously agreed to).

As a result of the oversupply of vessels Tractug could not meet its debt obligations and filed for Chapter XI. Although Tractug was beginning to put itself out and was showing itself as one of the best run tug operations in the U.S. MarAd has seized the fleet thereby killing my hope of reorganization and recovery for all creditors.

It should be noted that boe MarAd seized the fleet it did everything it could to drive Tractug out of business, even though its actions were contrary to its own interest. For example it interfered with Tractug's charters and caused the cancellation of a lucrative charter with PEMEX. That action alone not only killed reorganization chances but also diminished the resale price of the tugs because they will now be sold without a profitable charter.

Now that MarAd has seized the tugs it has to pay for their maintenance (something it didn't have to do before seizure) and the tugs will be worth less at a sale because they are not part of an operating fleet with trained crews and on-going market penetration. MarAd even damaged one of the tugs when they seized it.

MarAd has acted spitefully and without good business sense. Giving it authority to seize assets outside the normal course of bankruptcy proceedings will only foster its arrogance and prevent the management of assets in a businesslike, profitable manner.

This is special interest legislation designed to circumvent established bankruptcy laws. Why should the government be granted special favors when they are clearly competing in a commercial world. The proposed bill benefits rich established companies who have been able to weather the bad economic climate. This proposed bill would jeopardize the innovators in our investment spectrum and discourage investment in innovative ideas all to the detriment the American taxpayers.

In summation, attached pleasend an economictly have a pending law suit against MarAd. In conclusion, wee you to not enact this special interest legislation.

Sincerely,

THOMAS J. FAUST, *General Partner.*

Enclosure:

ECONOMIC CLAIM

Re: Negligence in Economic Analysis; Negligence in Fiduciary Administration of Title XI Program; Negligence in causing Tractug to suffer irreparable financial and economic loss; Maladministration of Title XI, Tractug contract.

MARAD caused our Chapter 11 and as MARAD is the cause of our Chapter 11, MARAD owes us $52,300,000 in monetary damages. Over $6.3 million in investor funds have been lost. Ten years profits have been lost amounting to another $15,000,000. A loan has been defaulted on for $25,000,000 plus creditors have not been paid. $2 million to unsecured creditors and $4 million in secured creditors has not been paid. A breech of contract claim has already been filed for MARAD's nonpayment of $3,851,235 thereby causing $3,600,000 in delay and disruption damages and over $1,200,000 in idle facility damages. This caused the debt level to rise 30% higher, thus destroying the economics of Tractug's project. This is obvious negligent fiduciary administration on the part of MARAD.

Due diligence filings filed with MARAD in 1979 and 1980 on the soundness of the three West Coast markets; Seattle, San Francisco and Los Angeles, proved that the market could not support the twelve new tugs proposed by Tractug, on the West Coast.

Tractug was found economically sound in August 1980. From September 1980 through 1984. MARAD awarded $382 million in new title XI guarantees to the tugboat and tug supply market. This figure converts to some 136 vessels built on Title XI guarantees at that time period.

[Dollars in thousands]

	1980	1981	1982	1983	1984
Additions to fleet	$79,000	$125,836	$119,024	$21,240	$37,802
Additional MARAD vessels	35	41	41	6	13

These other vessels are capable of doing ocean towing, barge work, and ship assist work and thus directly or indirectly take revenues away from the Tractug vessels. All of these vessels have lower breakevens than the Tractug vessels, because their cost is averaging $400/brake horsepower vs over $1,100 for the Tractug vessels. For example in the Santa Barbara offshore market, supply boats regularly complete with tugs for movement of rigs and towing of barges and target towing with the Navy.

Had the Maritime Administration subjected all companies to the same proof of economic soundness studies as those produced by Tractug on its application, the majority of these vessels would not have been constructed and Tractug would not be in Chapter 11.

The Department of Transportation, Maritime Administration seemed willing, if not very eager to assist in financing with Title XI guarantees. The Maritime Administration thus destroyed the economics for Tractug. MARAD by their mismanagement of the Title XI program, caused Tractug to lose its investment and forced it into Chapter 11 bankruptcy.

MARAD thus causing Tractug's bankruptcy and subsequent losses, owes for damages. The amounts owed are, a loss of $6.3 million in privately invested funds, $15 million in loss of operating profits and $25 million for the amount of the construction loan, plus $6 million damages to secured and unsecured creditors. The total of $52.3 million is claimed as damages. This figure does not include the legal losses sustained by Tractug as a result of Marads mismanagement. These fees will be included. However, since there is still on going proceedings, this cost cannot be determined at this time.

Due diligence filings filed with MARAD in 1979 on the soundness of the West Coast markets, Los Angeles, San Francisco and Seattle, proved that the market could not support Tractug's 12 new tugs, filed on the original Title XI application. Eight tugs were finally found to meet the economic soundness test required by MARAD. On August 28, 1980 MARAD issued an economic soundness certification and loan guarantee. Included in the economic soundness filings was the fact that off shore oil patch and tow work would make up a significant portion (40%) of Tractug's business.

In 1981 the US and world economies began to experience a recession. Domestic water borne traffic declined, thus causing an over supply of towing vessels. Oil prices declined, thus causing offshore tow supply vessels to be idle and to relocate to the West Coast. So effective were the low tug/supplies day rates, that Tractug never realized a 40% utilization in the offshore market in 1982. Approximately 20 Gulf Coast vessels traveled to the West Coast causing oversupply on the West Coast markets. However, in the declining market MARAD guaranteed an additional $382 million in Title XI construction funds, for 136 additional tugboats and tug/supply boats. This is blatant mismanagement on the part of MARAD. MARAD further aggravated the economic depression in the marine market place.

MARAD trimmed Tractug's venture from 12 to 8 vessels, but subsequently approved an additional 136 competing tugboats and tug/supplies for the market place. This is not only proof of MARAD's mismanagement on MARAD's part, but extreme negligence.

SHIP ARRIVALS

	Los Angeles area	San Francisco area	Seattle/Tacoma	Totals
1975	4,804	3,698	2,038	10,540
1976	5,044	3,982	2,260	11,286
1977	5,445	3,998	2,395	11,838
1978	6,765	4,150	2,574	13,489
1979	7,739	3,988	2,679	14,406
1980	7,122	3,979	2,762	13,863
1981	7,343	3,705	2,666	13,714
1982	6,766	3,748	2,880	13,394
1983	6,539	3,470	3,079	13,088
1984	6,975	3,681	3,355	14,011

The analysis alone of West Coast Ship arrivals demonstrates that no new tugs are required on the West Coast to service the trade. The ship assist market is now mature and has become a stagnant growth market.

In a declining West Coast ship assist and towing market, MARAD encouraged Dillingham Maritime to build 6 additional tractor tugs, 16 months after approving Tractug. MARAD encouraged Marine Leasing Co. and Crowley Maritime to purchase from, Nolty J. Theroit Inc. and Robin Towing Corp., vessels built with Title XI funds. Most of these vessels have since come to the West Coast.

The drop in total vessels calling at Long Beach, San Francisco, and Seattle markets can be explained by the rationalization and decrease of trade, increased vessel size and a decrease in port calls due to shipping lines no longer operating. With these statistical figures available, MARAD caused Tractug further harm by selling the Robin and Theroit vessels, and in 1981 financing 6 West Coast tractor tugs for Dillingham.

From 1983 to 1985 the MARAD office of finance guarantees made over 20 restructurings or workouts, that have been to the benefit of the debtor. MARAD has allowed no such plan with Tractug. MARAD continues to press that the stipulated value of the Tarctug vessels is $22.3 million. Tractug claims that the value should be based on historical liquidation values. This value is considerably less the MARAD's assessment. The liquidation value based on historical figures should be approximately $7.8 million. On November 4, 1985 the bankruptcy judge ruled against Tractug and lifted the stay, allowing MARAD to seize the Tractug vessels. MARAD argued that Tractug could not pay $230,000 per month to provide adequate financial protection to MARAD. Using the historical values, MARAD had full protection given a payment of $63,000 per month.

MARAD by continued argument, has now totally ruined Tractug, its investment, and its employees. MARAD has violated our constitutional rights, and in doing so, has denied Tractug due process and equal protection under the constitution.

EXHIBIT**—HISTORICAL VALUES

Vessel	BHP	Price/BHP	Actual cost to Crowley
Robin V	4860	$327.00	$1,593,179
Robin VI	4860	330.00	1,605,501
Robin VII	4860	333.00	1,620,257
Robin VIII	4860	332.00	1,613,733

EXHIBIT**

Tractugs	BHP	Price/BHP	Historical market value
ZP Condon	3000	$330.00	$990,000
ZP Chalone	3000	330.00	990,000
ZP Caymus	3200	330.00	1,056,000
ZP Chandon	3200	330.00	1,056,000
ZP Montelena	3200	330.00	1,056,000
ZP Montali	3200	330.0-0	1,056,000
ZP Acacia	3200	330.00 x 90%	950,400
ZP Carneros	3200	330.00 x 60%	633,600
Total			7,788,000

MARAD's seizure of Tractug vessels only strengthens our case. Tractug pioneered the new tugnology in America. Tractug was able to lower operating costs due to advanced vessel design and management efficiencies. Proof of the fact that Tractug is a leader in the industry, can be seen as leading operators have recently constructed similar vessels.

Critics of the Tractug venture, remark that operating under chapter 11 (a situation caused by MARAD's negligence and Maritime Administration loan default) allowed Tractug to operate at reduced rates. The fact of the matter is, that Tractug's ability to operate at lower cost, than any other vessel operator, is due to the highly efficient and well designed vessels which MARAD originally guaranteed.

Proof of the above fact, is that most all leading operators in the marine industry have witnessed the "modern tugboats" operate, and consequently have followed suit in their own attempt to match Tractug's pioneering "low operating cost" concept.

"MARAD's answer to economic over capacity" is the seizure of Tractug's vessels. MARAD is again making a serious mistake. With Tractug's design, one tractor tug can do the work of three conventional tugs, this is due to the range of horsepower and maneuverability which Tractug's vessels employ; a factor which foreign operators have realized long before any American company.

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